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FOREIGN OPERATIONS, EXPORT FINANCING, AND RELATED PROGRAMS APPROPRIATIONS FOR 1991

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

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FOREIGN OPERATIONS, EXPORT FINANCING, AND RELATED PROGRAMS APPROPRIATIONS FOR 1991

TUESDAY, FEBRUARY 27, 1990.

EASTERN EUROPE: CHANGES IN OPPORTUNITIES AND OBLIGATIONS

WITNESSES

WILLIAM E. GRIFFITH, PROFESSOR OF POLITICAL SCIENCE, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

ED A. HEWETT, SENIOR FELLOW, BROOKINGS INSTITUTION

JEFFREY SACHS, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

CHAIRMAN'S OPENING STATEMENT

Mr. OBEY. Good morning. Today we begin our first hearings for Fiscal 1991, with two days of overview hearings focused on changes in the world during the past year.

We need to ask ourselves where foreign aid should be going; how foreign aid should adopt to the changes in the Soviet Union, Eastern Europe and other regions of the world.

To say that 1990 is the first year of the New World has become almost a cliche, but it really is true in many respects. It is at least the first year of the post-World War II period.

SOVIET UNION

In the last 45 years, the focus of our foreign policy has been on the threat from the Soviet Union, which arose from the Soviet failure to keep the promises which they made at the end of World War II. Our policy was rooted in Soviet domination of Eastern Europe and their expansionist ideology—often with expansionist tactics in the Third World and elsewhere.

The United States, which in World War II served as the arsenal of democracy, has served since then as the guarantor of western values, democracy, and many other valuable ideas. This effort has been costly, but we have now begun to see the Soviet Union engage in the kind of conduct which they were supposed to be engaged in at the end of World War II.

Mr. Gorbachev has been reforming the Soviet Union internally and his signal that the Soviet Union would not use troops to keep communist governments in power in Eastern Europe has brought forth incredible change.

We have seen the Solidarity led government take power in Poland. We have seen the Berlin Wall crumble. We have seen a jailed playwright become President of Czechoslovakia. And in the short space of a month's time, we have seen him deliver his speech to Congress which in my view was the most transcendent that I have heard in the 20 years that I have been in Congress. I think in many ways it was the most important speech delivered in the United States since Winston Churchill's speech in 1947.

Until this day, we have been spending $300 billion a year on military budgets. Roughly half of this has been aimed at defending Western Europe and Japan. Many parts of our foreign aid budgets have been justified by a succession of administrations on the grounds that we were defending and promoting our interest in the Third World against Soviet or Marxist intrusion or domination.

Now, in addition to the changes in Eastern Europe, we seem to be seeing a number of changes in the Third World as well. Soviet activities in the Third World seem to have shifted in two respects. First, their activities would seem to me to be less ideological and related more to Soviet geo-political interests, instead of focusing so heavily on Marxist outposts such as Ethiopia, Mozambique, or Vietnam. They seem to be redirecting some of their attention to major regional players, regardless of ideology.

Administration witnesses have testified that the Soviets seem to be signaling they want a more conciliatory situation in a number of places such as El Salvador.

EASTERN EUROPE

We need to change our aid budget as well as our military budget. We have had members of Congress and others suggest changes in foreign aid to free up money for Eastern Europe. We have also had others suggest that more funds need to be freed up for Africa and Asia.

The focus of these hearings the next two days will be on a number of questions. What problems, opportunities and obligations should we anticipate in Eastern Europe? In other areas of the world, how we should reshape our aid program to reflect changes in the conduct of our principal adversary? What is the affect of those changes on aid recipients? The first of those hearings today is on Eastern Europe.

Many of these countries are at different points on the same continuum. The first step for them was essentially to decapitate the pre-existing leadership. They have done that—sometimes literally, sometimes figuratively. The second stage is the necessity for institution building, both economic and political. Those countries are in the process of moving toward elections. They have had numerous requests for assistance for emerging parties, and for simple acts of communication and organization. We have just provided an additional $10 million in assistance for that purpose.

The next problem is economic. These countries are trying to do something that has really not been done before—to take a centrally directed economy and devolve it into something approaching the free market system. That means those countries need help to establish everything from a real pricing system, to financial devices such as central banking, insurance, bankruptcy, et cetera. These steps will be necessary for an economy to function in a market situation and attract outside investment.

In the hearings today, we would like to get a realistic assessment of what has happened; some idea of what may happen next; an evaluation of their needs; and an indication of what ought to be the magnitude and the nature of our response, both bilaterally and multilaterally.

Distinguished experts on Eastern Europe will be addressing these issues today. We will hear from Dr. William Griffith, Professor of Political Science at MIT, followed by Dr. Ed Hewett, Senior Fellow at the Brookings Institute, and Dr. Jeff Sachs, Professor of Economics at Harvard.

Gentlemen, we have your statements and will insert them into the record. Why not simply take as much time as you desire to summarize them. I do not want to be stingy about the five minute or ten minute limitation because you know much more about many of these subjects than we do.

All I would say, Bill and Ed, is that I wish this meeting were taking place in the places where we have often met in the past to discuss these questions. [Laughter.]

Mickey, would you like to say anything before we begin?

Mr. Edwards. I would just second that last part. I am ready to go right now. [Laughter.]

Bill, why don't you proceed.

Mr. Griffith's Opening Statement

Mr. Griffith. I will stick pretty close to my statement which I hope will not be too long.

GENERAL AID CONSIDERATIONS

I should probably begin with a statement of what is not known, subject to the more enlightened view of my economic colleagues, I do not think we know exactly how much aid the East European economies will need in order to carry out the transition from a communist to a capital market economy, and from a political dictatorship to a political democracy.

We certainly do not know how much the political developments in the area in the world may interfere with or even further these processes of economic and political transition.

What we do know is that the transition will be long and cannot be successful without more Western aid than has yet been decided. And most importantly for this country, we know that compared, especially to the European communities, and therein, primarily the Federal Republic of Germany and to Japan, the United States Government and American private industry are doing considerably less than this country's Gross National Product would justify.

In short, we are not only not taking the lead in aid to Eastern Europe, but we are in my judgment doing far less relatively and absolutely than we can and should. This applies both to the Eastern European countries where we have already committed aid and to those where we have not yet but should.

The question is therefore, why are we not playing a leading role in Eastern Europe? The first and probably the most cause is domestic. We are living far beyond our means, and unless and until government expenditures are further cut and taxes raised, we cannot expect to be taken anywhere nearly as seriously as we once were, either in Eastern Europe or more importantly in Western Europe or Japan.

While the administration's cuts in the defense budget, small as they are, are positive, it seems to me that they fall far short of what can safely be afforded.

Further cuts would make it possible to move toward balancing the budget, to improve our domestic situation and to give more aid to Eastern Europe.

The second cause of this change in our position is international: the rising economic power of the Federal Republic and of Japan. This has made it possible, especially if we do not fall into the trap of protectionism, to share with them the burden of aid to Eastern Europe.

But it should not mean and need not mean that the United States should revert to neo-isolationism. On the contrary, the security and military requirements of managing detente in Europe, the verification of mutual ground force cuts alone, will fall primarily on us and on the Soviet Union.

And although we must hope that Gorbachev will remain in power and continue his present policy, his situation with respect to the economy and to nationalities' tension is getting worse rather than better, and will probably get worse still.

Moreover, as recent Romanian developments certainly show, at least some of Eastern Europe's revolutions have brought far from stable results.

Nor in my judgment can we trust in the present administration to allot enough aid and fast enough to Eastern Europe. After all, its initial proposal of $100 million of aid to Poland and Hungary was almost absurdly inadequate, and it was only the efforts of the Democratic majority in both Houses of Congress that brought it up to its present level of some $900 million between now and 1992.

Moreover, I have the impression that American aid to Eastern Europe has been primarily in the form of government credits for food aid, while in contrast, the aid by the Federal Republic and Japan has been primarily given in the form of insurance risk guarantees for private West German and Japanese business ventures in Eastern Europe. A form of aid which seems to me to be preferable because it gives capitalist private enterprise, which is exactly what Western Europe needs, the opportunity to produce exactly the demonstration effect in the region which they need.

While the Export-Import Bank is still hampered by Jackson-Vanik restrictions for example, the West German and Japanese governments are actively searching for ways to help their private enterprise enter Eastern Europe.

This should be changed as rapidly as possible, and in addition, the United States should work, and I know has begun to work, with the West Europeans to soften COCOM relations and restrictions regarding Eastern Europe.

We now turn to the treatment country by country. "Eastern Europe" was really always a non-area and it is unfortunate that we still treat it as an area. It is simply the region that the Red Army overran in 1945.

The very varying histories of this region are now vigorously reinserting themselves, including the American and West European role in them. Histories which in the past all too often included fratricidal conflicts and prolonged terrorism.

EAST GERMANY

From the point of view of American political interests, one can divide this area into three parts. The first is East Germany, which has now been decided in Ottawa that it will join West Germany. Therefore, in my judgment, the German economy will probably be able, although under considerable strain, to modernize East Germany.

However, and this is not in my prepared testimony, the amount of money that West Germany will require will mean the kind of deficits which will produce inflation. But the West Germans will not allow inflation after the two experiences they have had with it already.

Therefore, they will raise interest rates in order to prevent inflation, and this will mean that unless we raise interest rates as well, the money we need to pay for our unfortunate deficits will go to Germany where they can get higher rates.

Thus, there is a serious problem of an international nature in this respect, which my colleagues I am sure know much more about than I do.

As to the politics of all of this, a proposal has been made by Genscher and endorsed by the United States, Czechoslovakia and Hungary and by France and England, to the effect that a united Germany be a full member of NATO, but that NATO troops would not be stationed, although perhaps Soviet troops would be in what is now, but not for long, the German Democratic Republic.

I think this is a reasonable compromise with legitimate Polish and security interests, provided that a united Germany immediately and de jure guarantees the present German-Polish frontier and that this guarantee be reinforced by a CSCE summit guarantee of the 35 nations involved, at the meeting scheduled in November.

POLAND, CZECHOSLOVAKIA, AND HUNGARY

The second region includes Poland, Czechoslovakia and Hungary. The United States played an important historical role in Poland and Czechoslovakia at the end of World War I.

It was one of the main advocates of the restoration of Polish independence, including the corridor to the Baltic Sea and it was the main external power involved in the establishment of a free and independent Czechoslovakia.

Moreover, there are some six million Polish-Americans in this country and a substantial number of Czech and Slovak-Americans, who have a long-standing and quite legitimate interest in the fate of these countries.

Poland, the first of these countries to regain its independence, is unique. There is no equivalent of Solidarity elsewhere in Eastern Europe. Moreover, after Solidarity came to power in Poland last year, it has launched, with the assistance of one of my colleagues here, the first major attempt anywhere successfully to undertake the transition from a totalitarian to a market economy.

For this, Poland has been given a major currency reform guarantee fund, at least $1 billion from the Group of 24, including the U.S., which I understand has not yet been, have to be drawn down on which is an encouraging sign.

Some indications of the reform seem positive and the Solidarity Government's public support remains high, around 80 percent, which, concerning the economic strain on the country, is almost a miracle. It shows that patriotism for a while can overcome economic hardship.

But the reform has only been in operation for less than two months. Social strains are mounting rapidly. It is far too early to know whether or not it will succeed. If it does it will be a model for some other European countries and for all countries who want to transit from a dictatorship to a democracy economically.

But if it does not, it will so discredit the possibility of a transition to capitalism that it is in my judgment close to essential that it not fail.

Czechoslovakia is in a much better position. It was a highly developed country a half century ago, and it has the strongest democratic tradition in all of Eastern Europe. It needs managerial assistance, and it could very well use, I think, the kind of American universities abroad that there is, for example, by SAIS and Bologna and in one of the most beautiful cities in the world, in Prague, but it certainly should be encouraged to get private and Western capital.

Hungary, even more than Poland, has an overwhelming foreign hard currency debt burden, the highest per capita in Eastern Europe. However, because of traditional German-Hungarian ties, and because Hungary last year was the first country to let West Germans go through Hungary and Austria to—to let East Germans go through Hungary and Austria to West Germany—the Federal Republic has already loaned Hungary around $1.3 billion, and thus saved it from default.

Bonn will probably continue to play the main role in aid to Hungary, but the United States should be present as well, as it already is with the Hungarian management school.

And although it is true that Hungary is still officially ruled by communists, they have renamed themselves socialists and the forthcoming spring, a free election will almost surely throw them out of office.

OTHER EASTERN EUROPEAN COUNTRIES

Bulgaria and Romania are still ruled by more or less reformed communists, fiercely opposed by noncommunists who will probably overthrow them in the second of these revolutions.

Their democratic traditions are weak. The Romanian economy was wrecked by Ceausescu. Here it seems to me that Secretary Baker's recent Prague speech applies. The U.S. should give aid only in proportion to progression toward democracy and toward a market economy.

Neither of these countries has as yet passed this test and their prospects are at best uncertain.

Yugoslavia is a special case, one to which too little attention has been paid in this country in recent years. It is economically in the first stages of a Polish type of reform, which I think Professor Sachs could tell us also more, whose outcome is at least as uncertain as in Poland.

Since before it was proclaimed the yearly inflation rate was well over 2,000 percent, however, the foreign trade balance has recently improved.

Yugoslavia is like the Soviet Union, a multinational state. Its most developed, most western and northern states, Slovenia and Croatia, have however a lower population than Serbia which is 40 percent of the country's territory.

Serbia, unfortunately, has fallen into rabid nationalism, under the leadership of a charismatic demagogue, Slobodan Milosevic and is so oppressing its Albanian subjects in the Kosovo, that the situation there is probably the worst human rights scandal in all of Europe. Its only rival probably is Northern Ireland.

The United States helped Tito to resist Stalin, but a danger from Russia does not now exist. The United States has many historic reasons to be pro-Yugoslav, but on the other hand it has no reason to aid a country where such flagrant human rights outrages occur.

We should make clear to Yugoslavia and particularly to Milosevic that Secretary Baker's Prague speech and congressional policies will apply there as well.

INTERNATIONAL FINANCIAL INSTITUTIONS

I think in conclusion that the most important area, where the United States can assist Eastern Europe is through our leading role in international financial institutions, notably the World Bank and the International Monetary Fund.

It is in the American national interest that as much aid and investment guarantees as possible to Eastern Europe be through international agencies, such as the Group of 24, The Bank and The Fund.

Second, it is exactly in The Bank and The Fund where the U.S. has the most clout and it should use it probably more than it has but discreetly and quietly in favor of market economies, democracy and human rights. It should do this in cooperation with the European community and Japan.

But just as with South Africa, it is the United States which can and should take the lead, particularly in terms of democracy and human rights. It should also take the same lead, of course, toward right-wing authoritarian dictatorships.

POST-COLD WAR RELATIONSHIPS

The Eastern European revolution and the near collapse of the Warsaw Pact raise serious questions for the future of NATO. What Secretary Baker in his recent speech has called an increased political role for NATO would be a long and difficult transition at best. But it seems probable in the medium term that NATO and the

Warsaw Pact, however little the latter really means, will increasingly concentrate on verification and troop cuts.

There is also increased sentiment, particularly in the West German foreign ministry for some kind of overarching European security system, but this is so far only one of the many ideas about NATO's future.

It would probably be inadvisable for the United States to embrace this idea too rapidly or too completely, even though it may be an idea whose time eventually will come. If only because it would make even more difficult the maintenance of what seems to me to be important; that is to say, of significant, although far less, American troop strength on the continent of Europe.

The danger in this is twofold. First, the Soviet Union may be forced to leave Eastern Europe and American public opinion may force us to leave Western Europe. This would endanger American-West European political and economic relations. It would increase the danger of instability in Eastern Europe and it would leave Western Europe ill-prepared on its own.

In addition, there is the even greater danger of a Soviet Union disintegrating with all the nuclear weapons that it has. It is clear that NATO and the European community and above all, the United States have won the Cold War, and the Soviet Union has lost it and its East European empire in the process.

It seems indeed to have lost the imperial will which is so important to maintain empires. It may well be, indeed, I lean myself to this view, that the Soviet Union itself slowly and only in part is in the process of breaking up.

This will be a process which is hardly likely when added to their own potential instabilities, to leave Eastern Europe untouched, and although in my judgment, a united Germany will be a democratic gain for the West and not a danger, there are still many Europeans who think the contrary, and many—probably too many Americans as well.

For all of these reasons, therefore, it would not only be ironic, and indeed counterproductive and potentially dangerous, if the United States would once again for the third time have won a war and then gone home. Our economic and strategic interests in Western Europe and our political and security interests in Eastern Europe seem to be leading toward what, I hope, will be a bipartisan American consensus:

To cut our defense expenditures more than we planned, but not to relax into isolationism, to spend more on our domestic disgraces and on aid to those countries in Eastern Europe which meet the triple test of democracy, market economy and human rights.

If we do all of that, then we as a people will be able, considerably more than we have already, to set a standard to which others may repair.

Thank you.

[The prepared statement of Mr. Griffith follows:]

TESTIMONY

BY

PROFESSOR WILLIAM E. GRIFFITH
Ford Professor of Political Science
Massachusetts Institute of Technology

I am pleased and honored to testify before your Subcommittee today with respect to the needs of Eastern Europe as a result of last year's revolutions there. I shall concentrate on the political and security problems, since my colleagues here will discuss the economic aspects.

With respect to my expertise in this field, I have written and edited several books on Central and Eastern Europe. I most recently edited Central and Eastern Europe: The Opening Curtain? (Boulder, CO: Westview for the East-West Forum, 1989). I have just completed editing, also for the East-West Forum, a new volume centering on Soviet-American economic relations.

GENERAL CONSIDERATIONS

I must begin with a statement about what is not known. We do not know exactly how much aid the East European economies will need in order to carry out a successful transition from a communist to a capitalist market economy and from a political dictatorship to a political democracy. And we do not know how much future political developments in the area and the world may interfere with (or even further) these processes of economic and political transition.

What we do know is that the transition will be long, and cannot be successful without more Western aid than has yet been decided upon. And, most importantly for this country, we know that, compared especially to the

European Community (and therein primarily the Federal Republic of Germany) and Japan, the United States government and American private industry are doing considerably less than this country's gross national product would justify. In short, we are not only not taking the lead in aid to Eastern Europe (and a good case can be made that we should not do so everywhere and always), but we are, in my judgment, doing far less, relatively and absolutely, than we can and should. This applies both to the East European countries where we have already committed aid, and to those where we have not yet, but should.

Why are we not playing a leading role in Eastern Europe? The first cause is domestic: we are living far beyond our means, and unless and until government expenditures are further cut and taxes raised, we cannot expect to be taken anywhere nearly as seriously as we once were, either in Eastern Europe or, more importantly, in Western Europe or Japan. While the Administration's cuts in the defense budget, small as they are, are positive, it seems to me that they fall far short of what can safely be afforded. Further cuts would make it possible to balance the budget and also to improve our domestic situation, while still giving more aid to Eastern Europe.

The second cause is international: the rising economic power of the Federal Republic of Germany and of Japan. This has made it possible, especially if we do not fall into the trap of protectionism, to share with them the burden of aid to Eastern Europe. But it should not mean, and need not mean, that the United States should revert to neo-isolationism. On the contrary, the security and military requirements of managing detente in Europe, the verification of mutual ground force cuts alone, will fall primarily on us and on the Soviet Union. And although we must hope that Gorbachev will remain in power and continue his present policies, his situation with respect to the economy and nationalities tension is, if anything, getting worse rather than better. Moreover, as recent Rumanian developments show, some of Eastern Europe's revolutions have brought far from stable results.

Nor, in my judgment, can we trust in the present Administration to allot enough aid, and fast enough, to Eastern Europe. After all, its initial proposal of $100 million dollars of aid to Poland and Hungary was almost absurdly inadequate, and it was only the efforts of the Democratic majority in both houses of Congress that brought it up to its present level of some $900 million between now and 1992.

Moreover, I have the impression that American aid to Eastern Europe has bee primarily in the form of government credits or food aid, while in contrast, the aid by the Federal Republic and Japan has been primarily given in the form of insurance risk guarantees for private West German and Japanese business ventures in Eastern Europe. This form of aid seems to me to be preferable to ours because it gives capitalist private enterprise, which is just what Eastern Europe needs, the opportunity to produce exactly the needed "demonstration effect" in the region. While the Export-Import Bank is hampered by Jackson-Vanik restrictions, for example, the West German and Japanese governments are actively searching for ways to help private enterprise enter Eastern Europe. This should be changed as rapidly as possible, and in addition, the U.S. should now work with the West Europeans to soften COCOM restrictions regarding Eastern Europe.

COUNTRY-BY-COUNTRY

"Eastern Europe" was always a "non-area," simply the region that the Red Army overran in 1945. The various histories of the region are now vigorously reasserting themselves, including the American role in them. These histories have in the past all too often included fratricidal conflicts and prolonged terrorism.

From the point of US political interests, I should divide the area into three parts. The first is East Germany, which will in all probability join West Germany in the near future. Thereafter, in my judgment, the German economy will be able, although under considerable strain, to modernize East Germany. A proposal has already been made by West German foreign minister Genscher and endorsed by the United States, Czechoslovakia, and Hungary, to the effect that a united Germany be a full member of NATO. Under that plan, NATO troops would not be stationed, although perhaps Soviet troops could, in what is now still the German Democratic Republic. I consider that to be a reasonable compromise with legitimate Soviet and Polish security interests, provided that a united Germany immediately guarantees de jure the present German-Polish frontier, and this guarantee be reinforced by a CSCE formal decision.

The second region includes Poland, Czechoslovakia, and Hungary. The United States played an important historical role in the first two at the end of World War I. It was one of the main advocates of the restoration of Polish independence, including a corridor to the Baltic Sea, and it was the main external power involved in the establishment of a free and independent Czechoslovakia. Moreover, there are some six million Polish-Americans in this country, and a substantial number of Czech- and Slovak-Americans, who have a long-standing and legitimate interest in the fates of these countries.

Poland was the first of these countries to regain its independence from the Soviet Union, and there is no equivalent of its Solidarity national movement elsewhere in Eastern Europe. Moreover, after Solidarity came to power in Poland last year, it has launched the first major effort anywhere to successfully undertake the transition from a totalitarian to a market economy. For this Poland has been given a currency reform guarantee fund of $1 billion from the Group of 24 (including the US), which has not get had to be drawn down. Some initial indications of the reform seem positive, and the Solidarity government's public support remains high--around 80%. Yet the reform has been in operation only less than two months; social strains are mounting rapidly, so it is far too early to know whether or not it will succeed. If it does, it will be a model for some other East European countries. But if it does not, it will so discredit the possibility of a transition to capitalism that it is in my judgment close to essential that it not fail.

Czechoslovakia is in a much better position, because it was a highly developed country a half-century ago and because it has by far the strongest democratic tradition in all of Eastern Europe. It needs managerial assistance but no major credits, although it should be encouraged to get private Western capital.

Hungary has, even more than Poland, an overwhelming foreign hard-currency debt. However, because of traditional German-Hungarian ties and because Hungary last year first let East Germans go to West Germany, the Federal Republic, has already loaned it around $1.3 billion and thus saved it from default. Bonn will probably continue to play the main role in aid to Hungary, but the US should be present as well, as it already is with the Hungarian Management School. Although Hungary is still officially ruled by communists, they have renamed themselves socialists, and the forthcoming spring will make them at best a minority partner in a non-communist majority coalition.

Bulgaria and Romania are still ruled by more or less "reform communists," fiercely opposed by non-communists. Their democratic traditions are weak, and the Rumanian economy was wrecked by Ceausescu. Here Secretary Baker's recent Prague speech seems to me to apply: the US will give aid only in proportion to progression toward democracy and a market economy. Neither of these two countries has as yet passed this test, and their prospects are at best uncertain.

Yugoslavia is a special case, one to which too little attention has been paid in this country in recent years. It is economically in the first stages of a Polish-type reform whose outcome is at least as uncertain as in Poland, because before it was proclaimed the yearly inflation rate was well above 2000%. (However, the foreign trade balance has recently improved.) Yugoslavia is a multinational state. Its most developed, western and northern states, Slovenia and Croatia, have a lower population than Serbia (which is 40% of the country's territory). Serbia has fallen into rabid nationalism, under the leadership of a charismatic demagogue, Slobodan Milosevic, and is so oppressing its Albanian subjects in the Kosovo that the situation there is probably the worst human rights scandal in Europe. The US helped Tito to resist Stalin, but a danger from Russia does not now exist. This country has many historic reasons to be pro-Yugoslav, but on the other hand it has no reason to aid a country where such flagrant human rights outrages occur. We should make clear to Yugoslavia, and particularly to Milosevic, that Secretary Baker's Prague speech will apply there as well.

A most important area where the US can assist Eastern Europe is through our leading role in international financial institutions, notably the World Bank and the International Monetary Fund. First, it is in the American national interest that as much aid and investment guarantees as possible to Eastern Europe be through international agencies such as the Group of 24 and the Bank and Fund. Second, it is exactly in the Bank and the Fund where the US has the most clout, and it should use it more than it has, discretely and quietly, in favor of democracy, market economies, and human rights. It should do this in cooperation with the European Community and Japan, but just as with South Africa, it is the United States which can and should take the lead. (It should do the same, incidentally, toward right-wing authoritarian dictatorships.)

The East European revolutions and the near collapse of the Warsaw Pact raise serious questions for the future of NATO. What Secretary Baker in his recent speech has called an increased political role for NATO would be a long and difficult transition at best, but it seems probable in the medium term, that NATO and the Warsaw Pact, such as the latter remains, will increasingly concentrate on verification and troop cuts. There is also increased sentiment, particularly in the West German foreign ministry, for some kind of overarching European security system, but this is only so far one of the many ideas about NATO's future. It would be inadvisable, in my opinion, for the U.S. to embrace this idea rapidly or completely, if only because it would make even more difficult maintenance of significant American troop strength in continental Europe.

The danger is twofold. First, the Soviet Union may be forced to leave Eastern Europe and American public opinion may force us to leave Western Europe. This would endanger American-West European political and economic relations, increase the danger of instability in Eastern Europe, and leave Western Europe ill-prepared on its own. In addition, there is the even greater danger of a USSR with nuclear weapons disintegrating.

It is clear that NATO and the European Community, and above all the United States, have won the cold war and the Soviet Union has lost it, and its East

European empire in the process. It may well be, indeed, that the Soviet Union itself is in the process of breaking up, slowly and in part only. This will be a process, if, as I expect, it occurs, which is hardly likely, when added to their own potential instabilities, to leave Eastern Europe untouched. And although in my judgment a united Germany will be a democratic gain for the West, not a danger, there are still many Europeans who think the contrary, and too many Americans as well.

For all these reasons, therefore, it would not only be ironic, indeed counterproductive, but potentially disastrous if the United States would once again have won a war and then gone home. Our economic and strategic interests in Western Europe, and our political and security interests in Eastern Europe, as I have set them forth here, seem to me to be leading toward what seems to be, and I hope remains, a bipartisan American consensus. I should hope that we can cut our defense expenditures more than we plan, but not relapse into isolationism; that we can thereby both spend more on our domestic disgraces and on aid to those countries in Eastern Europe which meet the triple test of democracy, market economy, and human rights; and that we as a people will be able, more than we have already, set a standard to which others will repair.

Mr. OBEY. Thank you very much. Ed.

DR. HEWETT'S OPENING STATEMENT

Dr. HEWETT. Thank you, Mr. Chairman, for the opportunity to come and speak to you today. Let me start by just sketching for the region as a whole the potential in Eastern Europe, and then talk about what we can do to help Eastern Europe realize that potential. I think it is helpful—although an oversimplification—to think about a best case and a worst case for the region as a whole. Obviously different countries could be at different ends of it.

ECONOMIC GROWTH SCENARIOS

The best case would be one in which the radical reforms that are now unfolding in Poland and soon in Hungary sweep the region and are managed fairly well. That is, the governments support them with a tight monetary policy, with a stable economic environment which is driven by privatization. And that out of that energy a region with relatively low cost labor and capital. It becomes a magnet for capital from abroad, begins fairly quickly to go into a phase of high growth for GNP and more importantly for living standards.

But even possibly more importantly still, exports begin to grow rapidly, as the region becomes a platform for sales to the European community, and even potentially for sales to the Soviet Union. It becomes a cheap west for the Soviet Union. And an efficient east for the European community.

If this best-case scenario unfolds, then the East European countries become a huge "Philippines" in the middle of Europe, a growth engine that could have a tremendous impact on European and on the world economy.

Even in this best case, governments could still change fairly frequently in the region, say at a rate of one new government per year. But that would be a sign of stability in a way, a sign that the political system was providing a safety valve for the political tensions arising from transition. Because even in the best case, the problems of transition in this region are so difficult that it will be hard for governments to remain intact for very long, even with their best efforts.

The worst case is half-hearted reforms, a loss of will to persist in the tough measures necessary to implement radical reforms; restrictions on foreign investment; restrictions on economic activity within these countries that leads to slower growth and therefore more restrictions; and inadequate development of exports and therefore low growth of living standards. In this case economic problems lead to political turmoil or, worst yet, to a superficial stability in the area that comes from governments that are moving back toward repression.

So far, speaking of the region as a whole, but particularly for Central Europe, this region seems to be tending toward the best case. But the question is what can we do to make sure that that trend continues.

Our basic goals should be to assist this region in creating an economic environment that will attract private capital. I am convinced that if this is to be a successful transition, public monies will be important only at the front. But the definition of success will be that the importance of these monies dwindle quickly as private funds move in to meet the bulk of financing needs.

TYPES OF ASSISTANCE

We should be quite aggressive in offering and assisting the region in putting together a plan for technical assistance, in designing economic policies, in designing economic systems. No one knows exactly how to create a market economy, but we know a lot more than they do about it and can be helpful. We are in many cases already doing that, including the superb work that Jeff Sachs has done in the region.

We also need to make available to the region grants and loans for infrastructure, for the start up of small business. But I emphasize just for the start up of small business and also for stabilization funds to support the introduction of convertible currencies.

Western policy towards this transition has been bending in precisely this direction. The United States, Europe, and Japan are engaged in a rather broad-based, technical assistance effort both at the government-to-government level. The IMF and the IBRD are increasing their activities with member countries and also will soon have more members in the region. The private sector is beginning to respond particularly in Hungary and in Poland and in Czechoslovakia, countries which have gone the farthest or at least look the most promising.

U.S. ROLE IN EASTERN EUROPE

The direction is not the issue. But the question is whether we could do more, and whether we could be better organized about it. And I think the answer to both questions is yes.

I agree completely with Professor Griffith that the United States really needs to resume a much more visible role than it has played recently in this region. We almost have what I would call a "stealth" policy towards the region. It is hard to find it some days.

We have set up under Deputy Secretary Eagleburger a rather informal ad hoc group that works on policy towards Eastern Europe, which includes highly competent professionals—but essentially invisible professionals. Secretary Eagleburger obviously has a full enough plate that probably whole days go by when he does not think about Eastern Europe.

It would make much more sense to create a special body to bring together both congressional and executive forces, but also the private sector, to coordinate our approach to this region. We should give that body some money, staff and a mandate to assure the needs of the region, and minimize the impact of the limited resources we can commit to its recovery.

This group would also work closely with our allies and with international economic organizations to coordinate our efforts and particularly technical assistance. I am struck now with the literal deluge of technical assistance that is being offered to some East European countries. I was told recently that the Poles asked Congress to stop sending delegations for a while, that they really enjoyed seeing them, but they had to spend a little time doing something. [Laughter.]

I wish the Soviets would issue the same ban, not against Congressmen, in particular. But there is a problem now that we are all gushing forth with this willingness to help, but there is no coordination to it. And while I am not a centralist at heart despite the economies I work on, I would like see a little bit more coordination.

Second, I think we need—the United States in particular needs—to be much more supportive of the European Bank for Reconstruction and Development (EBRD) and particularly the effort in that bank to finance infrastructure development. We have two problems as I understand it with this bank that is being under consideration right now.

One, we are concerned that loans might go only to state enterprises—or primarily to state enterprises—and we consider state enterprises in general to be inefficient and prone to waste money—which is true. But unfortunately that opposition is also causing us to oppose loans for infrastructure development in Eastern Europe. And I think that is where most of this public money should go.

That is where private enterprise will not invest, and where we can be helpful. Obviously the bill for infrastructure in Eastern Europe will be much larger than we can or should come up with. At some point it will dawn on all of your constituents that before you build bridges in Eastern Europe, maybe you ought to build them first in the interior of the United States.

But some investment infrastructure is obviously needed and with our support could make a big difference in what is our primary goal: that is attract private capital into the region.

Our second problem with the EBRD, has to do with infrastructure in the Soviet Union. We know the Soviets will be members and we are scared to death that Soviet demand for infrastructure will simply take all the money from EBRD.

To me that is a rather strange objection. Obviously EBRD will not have enough money to meet even the first demands that come from Eastern Europe. Even forgetting the Soviet Union, EBRD will be rationing capital from day one. We might as well admit that will happen, set criteria for it, and go ahead and try to get the highest possibly impact from the funds that are available.

Third, we need to be much more conscious of the environmental issues that now face this region, and we need to address them now rather than later. There are parts of Eastern Europe, particularly the northern part, that are environmental disasters. In East Germany, Czechoslovakia, Poland the use of coal, generally soft coal, has done terrible damage to the air, to the water, and to the land. What we need to do and urge Eastern Europe to do is face up to the issues now, not later. In particular, as this region tries desperately to attract capital, we should make sure that they not be drawn into attracting dirty technology from Western Europe or from other parts of the world.

There is a real danger this will happen, however strong the rhetorical commitments will be from these governments to preserving the environment. The pressures to come in will be enormous, and the various governments will need support and indeed some urging from outside. East Europe's environmental problems are Europe's problems, they are all our problems.

INTERNATIONAL COOPERATION

Finally, I think, we should urge upon Eastern Europe that these countries cooperate with each other in the transition. Not in the sense because they have traditionally "cooperated" through CMEA, but because they face common problems in the infrastructure, in the environment, and in funding washable strategies for privatization. They could, I think, somewhat reduce the cost of what they are doing by coordinating their efforts. President Havel has already urged such an approach and we should encourage it.

It is one of the few pages in the Marshall plan I think that we should take seriously. In the period right after the war we required Western Europe to coordinate its efforts and devise its own plan for aid. That was for good reasons, and for the same reasons we should urge upon Eastern Europe.

For example in the area of the environment, we could require as a quid pro quo for some of the funds we are giving to Eastern Europe the creation of an Eastern European environmental council which would undersolve an environmental census and devote some resources to beginning to clean up the environment.

I know this is an enormously expensive task. One State Department official was telling me recently that the $10 million we had allocated to the City of Krakow to begin to clean up the environment, would cover the replacement of one smoke stack over one boiler. And that maybe the whole aid budget would handle Krakow.

So it is a bigger problem than we really can manage ourselves. But that does not mean that you need to walk away from it. In urging a higher profile role for the U.S. I know that there are concerns that the result will be pressure on us to spend more than we feel we can afford in this effort.

My response is two-fold. First, as a matter of principle, I would like to see my country as assertive in taking a leadership role in the transformation of Eastern Europe, as it has been in taking the leadership role in posing sanctions on Eastern Europe and the Soviet Union.

Moreover I think we need to resist the cynical calculus that makes it easier to buy weapons than to finance the measures which would make those weapons obsolete. Support for the transformation of Eastern Europe is a good investment in the future of Europe, and a good investment in the United States' international security. If we nickel and dime the problem to death now, we all live to regret it.

Let me conclude by just a note on what we might expect of the Soviet Union. Most people have talked themselves into the point of view that the Soviet Union is so close to collapse that it is simply a nonquestion to ask what the Soviet Union could do to assist the recovery of Eastern Europe.

In the first place, the Soviet Union is not so much a poor country as it is a poorly managed country. And we should not let them talk us into any other point of view. But second in Eastern Europe, there is something we can ask them to do. They have done most of what we want. That is, they are withdrawing from Eastern Europe.

The problem is that economically they may be withdrawing precipitously by dollarizing trade with the CMEA countries almost instantaneously starting next year. I think there is a decent chance that that will happen, or at least the Soviets will try to do it.

Clearly in the long run that is the best thing that could happen to Eastern Europe. They must be taken off the dole. But we should urge upon the Soviets to coordinate with Eastern Europe the dollarization of trade to minimize the balance of payments impact on the region. We should make it clear to the Soviets that at least they owe this much to a region that in many ways they have damaged themselves.

If they instantly dollarize trade, it could amount to something like a $10 billion shock to East European balance of payments and add to the bill that we in the west will pay. So that we would find in addition to considerable bills that are coming up for the transition of the countries that we are paying for Soviet withdrawal, I think we should do our best to try to avoid that.

Thank you.

Mr. OBEY. Thank you very much.

Jeff, you are next.

DR. SACHS' OPENING STATEMENT

Dr. SACHS. Thank you, Mr. Chairman for the opportunity to be here. We have had two eloquent statements. And I agree very much with most of what my colleagues have said. I will try to put some additional thoughts on the table and some slightly different emphases.

This is a moment of urgency in the region. And it is therefore a time when the United States must move quickly. It is a moment of urgency because what is at stake is a successful and peaceful transformation of the region economically, and it is a time when most of the countries in the region are in the midst of a very deep systemic crisis.

If we can help with transitional finance to see them through this period, there will be very large returns, not only for these countries but for the United States. We are not in a situation where we are going to have to carry these countries for the long term, if we act decisively right now. Because, if we can help finance the transition period, we will not have to be there in the longer run.

U.S. ASSISTANCE

From our narrow point of view in helping the region, I would stress a couple of things. First, we hear a lot about the peace dividend and equally much about the fact that the size of the peace dividend is uncertain. I cannot think of a better way to invest a large peace dividend right now than to make sure that this transition can be handled as smoothly and as efficiently and effectively as possible.

If we want to lock in very large savings in the military budget in the future, then it seems to me small amounts of assistance to Poland, to Hungary, to other countries undergoing the transition to a market economy is our most effective way to achieve very large savings in the future.

So from a very narrow investment calculus. I think that this is the moment to move as quickly as possible with well directed U.S. assistance.

Moreover, even aside from the question of the budgetary savings, the U.S. role right now will play a decisive—have a decisive effect in the U.S. business role in the region in the future. As an economist acting on the ground in these countries, I can tell you that the U.S. business presence is hardly to be seen right now, in contrast to the presence of the Japanese and the Europeans. It is not simply a matter of proximity. The Japanese are almost as well organized for investment in commercial opportunities in East Germany, as the West Germans themselves according to bankers that I talked to recently.

And what is amazing is the lack of involvement of U.S. industry at this point. And, it is a matter of I think great commercial concern for us in the long term. What we do now in official policy assistance will make great deal of difference to the extent of U.S. commercial presence in the long term.

I think that this is something that is important to keep in mind. It is good for us, but it is also good for the region—for these countries. They do not want simply one country coming in and doing all of the investment in the area. They want a U.S. presence there in addition to a German presence, in addition to a Japanese presence, and so forth. And if we give well directed aid now, we can make a substantial difference in that regard.

I think, therefore, when we think about the costs, we will be remiss if we do not think about the benefits. Of course, it is easy to talk about and important to talk about the moral commitments and the long term benefits in terms of the spread of democracy and freedom. One should, of course, put those foremost.

But, I would like the members to keep in mind that there are real financial returns as well to what we do right now. These financial returns are potentially large and potentially important for the United States.

Let me say—before I get into specifics—two more general points. First, what the U.S. does should be done in a multilateral context. The U.S. is not going to provide the majority of funds to see this process through under any circumstances no matter how rigorous U.S. leadership were to be.

The U.S. is part of a multilateral process, and our assistance should be geared towards a multilateral process. I think it is fair to say as a rough estimate that given the U.S. proper role in the world that our share of funds as a general rule of thumb should be on the order of 20 percent to 25 percent of the kinds of assistance that go in both in terms of government assistance and assistance through the multilateral institutions.

So what should we do, and what should we also encourage others to do? We should make sure, as we did with the $1 billion loan to Poland, that our monies are appropriately leveraged. That loan was one in which the U.S. made a contribution of $200 million and then did exercise leadership of the Executive Branch to make sure that the other industrial countries put in an additional $800 million. The total $1 billion has marked a decisive form of assistance that allowed the Poles to go forward with both the stabilization program and the reform program that they have now launched.

A second general point that I want to make is, and it is a mind boggling one for me repeatedly, that small amounts of money coming in the right form can make an enormous difference right now, an unbelievable difference. What that means in general is that we should be looking to give money in a flexible form so that the governments in the region can use it to reap very large returns that they can identify.

POLISH ECONOMIC ASSISTANCE NEEDS

I have been asked recently, to give you an example, to help find $90,000 that is vitally needed to get the privatization effort started in Poland. This is simply mind boggling. The whole world knows that the privatization steps are profound and of utmost significance to Poland's reform program and to the whole region.

They have an intense shortage of funds inside the government, because they are facing a hyper inflation and a profound fiscal crisis far worse than anything we have ever seen here. The small amounts of funds needed right now to hire Polish consultants to start the process are simply not available. It is mind boggling. To move into an office building in Warsaw to start the process, connect telephones, fax machines, xerox machines, computer facilities, things that are in the range of tens of thousands of dollars are beyond the financial means of the Polish administration to finance right now. And, so help of a flexible sort is vitally needed. It will have very profound returns in the future.

Let me outline briefly the kinds of economic support that I think are most importantly needed. I will focus on Poland, because Poland is in the deepest crisis among the countries now undertaking active reform. Also, Poland is farther along in the process of dramatic change. And, so it has given us an idea of the kinds of assistance that are vitally needed.

The first and most important kind of assistance is short term balance of payments support. That is cash to go to the central bank and to the treasury of these countries in the context of multilateral adjustment programs. We started that process with Poland with the stabilization fund. That $1 billion loan was decisive in allowing Poland to create a convertible currency at the beginning of this year, which was in turn decisive in being able to carry out the further steps of a strong stabilization program and reform of the trading system, which is at the core of their overall economic reform program.

Poland will need continuing balance of payment support for the next couple of years, as will many other countries in the region. The money that we give in this form should always be in the context of an IMF supervised program. It should always be built into a balance of payment scenario as part of an overall adjustment program to give us confidence that the money is needed and will be spent in furtherance of reform. But it is the kind of money that is vital for destabilized economies to get both feet on the ground so that they could start the process of serious reform.

Also, this kind of special balance of payments support should be coordinated with our allies on the rule of thumb that this contribution is about 20 percent of the total.

I think it is fair to say that for Poland we would be making a very important perhaps vital contribution to the success of Poland's fragile but promising stabilization and reform program were Poland to receive from us on the order of about $200 million of balance of payments support for the next couple of years leveraged up on this rule of thumb to about $1 billion coming from the industrial countries for the region as a whole.

OTHER U.S. ASSISTANCE

I think that one could identify for the other countries of the region the need for establishing a convertibility fund such as Poland has received of perhaps $1.5 billion to $2 billion of which the share of the U.S. would be around $350 million one time.

For some of the countries, they will need more than this convertibility fund. They will need annual appropriations for a couple of years to see them through the most critical parts of the reform, but we are not talking in the order of billions of dollars a year in U.S. contributions. We are talking in the hundreds of millions of dollars a year for this most vital kind of short-term financing.

The second thing that is absolutely vital for us, and a place where we will benefit as well as these countries, is in providing technical assistance, and that is technical assistance of a particular kind, basically business assistance. What I have in mind is something that we are discovering with urgency in Poland right now.

CONVERTING STATE ENTERPRISES

Even after the state enterprises are completely decentralized, put on a market basis, with hardened budget constraints, tough financing requirements, facing world prices, end of subsidies and so forth, it will take a great deal of time for them to find new markets, find normal ways of marketing, find connections with the outside world, partners for investment, reorganization of the plant, selling off parts of enterprises, parts of factories that are closing down, in effect parts of factories that are unprofitable, finding outlets for exports which are mainly to Western Europe that are vitally needed and finding markets for inputs that will be key to the production process.

What is being discovered in Poland is that of these 7,000 or so state enterprises right now, most have not seen the light of day for 40 years. Recently, as part of a mission that I was involved with, a management consultant took a number of factory tours and is now expanding that effort to enlarge the scope with a phalanx of management consultants now to have a look at these firms.

What he discovered was both promising, but also quite scary. It was promising in that what was found was that there is enormous potential on the ground for increasing productivity, for reorienting production to improve the quality of products so that these companies can compete on world markets, find new markets and so forth.

But, what he also found was that even the most rudimentary kinds of commercial contacts of these firms to the outside world do not exist. These firms do not know how to market, they do not have connections with traders right now, they don't know how to find outlets for their products. They also don't know how to find the inputs that are needed on a competitive basis.

They need help in reorganization, help in simple accounting standards, help in creating profit centers and accounting centers within the firm for monitoring and managing.

They've been on the so-called soft budget constraints for 40 years, and that is whenever you're in trouble, you go get more money from the central bank, which was printed up and which eventually created a hyper-inflation.

Poland is desperately trying to stop that right now. These firms can survive if they can survive in altered form with improvement in management, with connections to U.S. and foreign firms, joint ventures, management contracts and so forth. But, to do this requires an enormous inflow of management talent, accounting talent, legal talent and so forth. All of this must come quickly and requires a substantial amount of money.

It is an area where I think we should devote our attention with great urgency because it is an area that allows us to have American expertise and American business make its presence felt in a way that is extraordinarily favorable, and which will be extraordinarily favorable for the Polish economy.

Let me stress the urgency of this to give you a picture of how vital it is to move quickly.

Poland has started a process of extreme monetary change. Their economy had broken down progressively in recent years. Solidarity inherited an inflation that was running at annual rates of 5,000 to 10,000 percent.

It acted decisively January 1st with measures that would be shocking by our political standards, closing 7 percent of GNP in the budget deficit over night, ending subsidies that caused a drop of real wages on the order of 25 to 40 percent, depending on measurement. They were willing to take all of these enormously hard steps because they understood that they were facing the financial abyss otherwise and had to act dramatically.

What is happening is, of course, that in addition to all of the personal hardships being faced is that the enterprises are finding that they have seen a collapse of the domestic market which was being sustained by easy credit. They are producing goods which with small modification in some cases and with no modification in other cases could find outlets in Western European markets, for example.

However, they don't know to do even these most rudimentary steps of getting the marketing done, getting the transport, getting the trade financing, and being able to survive.

These firms have several months of possibility to make these adjustments in order for this transition process not to result in a collapse of these firms. But, rather in a healthy adjustment to more efficient operation, it will be vital to quickly get that the managerial expertise—the management consultants from the outside, traders and so forth—on the scene in order to make this process work.

Already, the government is under tremendous pressure to ease the money supply again, and expand the domestic market—a recipe that would be guaranteed to incite a hyper-inflation once again to set off the spark.

They succeeded in ending the inflation. Now, they must succeed in the transformation. And, that is where our expertise is so vitally needed.

I think what has to be done in that regard is for the U.S. to commit on the order of $150 million or $200 million of funds available in flexible form to the Minister of Finance so that he can establish a fund available for enterprises in Poland that on a shared cost basis will be able to hire expertise of American management consultants, American accounts and others to help save these firms and reorient them in a profitable way, link them up with our businesses, link them up with Western markets in a way which will provide for a favorable transition of the economy, will enable the economic stabilization program to succeed, and will enable Poland to start growing its way out of this crisis.

POLISH DEBT OVERHANG

A third area that is necessary for our support is one that does not have direct revenue or expenditure implications for us necessarily, and that is the question of the foreign debt burden of these countries. Poland in particular, also Hungary, also Yugoslavia to a lesser extent, have been buried under foreign debt by 40 years of communist mismanagement.

These are bankrupt governments, no matter how you look at it. Poland owes $40 billion to the outside world. Its exports are about $7 billion to the West with a ratio of about six to one. Poland is about the most highly indebted country in the world measured as debt relative to export potential.

If this debt overhang remains, there is no long-term future. The debt must come down because as in a bankruptcy, one could not even hope to grow out of this. What one needs instead is a fresh start for the country in the context of the economic reforms that they are now undertaking.

As long as the overhang remains, major private investment will not come, and the only forms of finance are going to be you, the government. If we get the debt overhang down, then private business can move in on a market basis once again, assuming that the Poles and others that are in this situation continue with the market reforms.

So, the debt overhang is a budgetary issue in a special kind of way. As long as it remains, only official finance will come into these countries. Once it is removed, then you can get private market finance going again.

Now, the debt is both official and commercial bank debt. That means that you need a treatment both for the commercial banks under the Brady plan, and we should press for a strong and quick and swift and realistic solution for the commercial bank debt which would reduce the debt down to the level that is payable—down to perhaps 20 percent at the face value in a swift negotiation under the so-called Brady style negotiations. It is important for the administration to give urgent attention to that.

That covers about $9 billion of Poland's $40 billion in debt. Another $27 billion or so comes under the so-called Paris Club debt, which is government to government.

The U.S. share of the bank debt, by the way, is a couple percent, only most of the vast majority of the commercial bank debt and the overwhelming majority is European and Japanese.

Similarly, with the official debt, the U.S. share is on the order of $2.5 to $3 billion out of about $27 billion, so the vast majority, again, is not U.S. debt. Germany is the main creditor both of the commercial banks and of the private debt.

Not only do they need the Brady Plan, they need the official debt burden to be reduced by having the interest rates on this debt cut down to levels that are realistic.

What is important for us to understand is that nobody is collecting from Poland right now. Poland has rolled over this burden year after year after year because everybody understands on the official debt that Poland cannot pay. Yet, the overhang of debt cripples them in terms of the future because new firms and new private investments will not come in as long as the first lien on the country is $40 billion of official debt.

So, we are in a Catch-22. We are not really receiving any funds on the money that we lent, and yet that overhang is going to kill them in the future unless we address this.

I have tried to point out to German officials that they faced this situation in the early 1950s when Germany was trying to get started again after the war, and the U.S. government showed great leadership then in leading a process in which all of Germany's creditors both official and private cancelled about half of Germany's debt obligations in the so-called 1953 London agreement.

Now, our government must press Germany as Poland's major creditor to do the same thing that we did for them. We must say, we will join in the effort but you, Germany, must lead to show that really you are going to be the responsible power in the region that will give these countries a fair chance to get started again.

We need leadership and vision and willingness to participate. We need German leadership. We must call for leadership as one of the main responsibilities of our government.

DEMOCRATIC INSTITUTIONS

Finally, one area that does not require a lot of money but which is vitally needed is funds to support democratic institutions in these countries. I know in the case of Poland that the very process of democracy is threatened by the absence of even small amounts of funds. Fax machines for the parliament, there is no budget. $300, $400 per Fax machine, and yet there is only one or two Fax machines in the entire SEJM.

Similarly, it has been pointed out to me by the Polish parliament that they do not even have funds for any constituent service whatsoever. I have been told that they have a constituent service office, funding might be $1,000 a year. There is no budgeting available at all. Making the most minimal contacts between constituents and their democratic representatives is nearly impossible right now because of a shortage of funds. With some $10, $20, or $30 million well spent by the democratic institutions, we can make a marvelous contribution to the development of these institutions.

I have gone on. I thank you for your generosity of the time. I hope I have given you some concrete suggestions where rather small amounts of expenditures can have truly historic consequences for us and huge returns for us in the kind of world we are going to live in in the future and even in our own financial and economic circumstances. Thank you.

Mr. OBEY. All right. Thank you all very much.

DEFENSE CUTS IN EUROPE

Bill, let me ask you first of all to try to set the framework. On page 3 of your statement you make the point "While the cuts in the defense budget, small as they are, are positive, it seems to me that they fall far short of what can safely be avoided." What would your judgment be about how much we can reduce that budget in terms of expenditures which have been directed in the past at the defense of Western Europe?

Mr. GRIFFITH. Well, I am no defense specialist, but I know that a colleague of Ed Hewett, Bill Kaufmann at Brookings and Harvard, has proposed that we can have an adequate defense budget at $150 billion a year. I cannot really judge this, but I think that in Western Europe and specifically the Warsaw Pact, with the very partial exception of Poland and even hardly that, has converted itself into what amounts to an advance glacis of NATO against any potential Soviet attack.

Now, there is no potential Soviet attack at the present time, but the idea that the East European nations should be considered a threat to this country when in fact they are a potential threat only to the Soviet Union seems to me to be quite absurd.

And, therefore, from that point of view alone, I think that it makes very great sense to have to continue to have a minimal American and Soviet presence particularly in the Federal Republic, and I am speaking here of probably no more than 100,000 troops each for a limited time, as Chancellor Kohl pointed out the other day. The main purpose of that should be verification of the arms control agreements in CFE and a guard against destabilization in Eastern Europe and in what will undoubtedly be the partial disintegration of the Soviet Union. But it should not, because it cannot any longer, be justified on the basis of a Soviet attack capability because there is little capability and no intention.

THE POLISH BORDER

Mr. OBEY. As you know, there is some question being raised about the clarity of Mr. Kohl's statement about the Polish border. Given that situation, the Polish government has indicated they would prefer to see Soviet troops remain in Poland. This is complicating our efforts to get as many troops out of Eastern Europe as possible.

I have two questions. Do you think it would be practical to consider a situation in which the Soviets would be gone from Poland, but still maintain significant troops in Eastern Germany?

Second, do you think we should press Mr. Kohl for a further clarification at an early date, or wait until we get into the two German and four-power discussion of the situation?

Mr. **Griffith**. As to the first question, it would undoubtedly be difficult to have a significant Soviet troop presence in Eastern Europe in East Germany and have no Soviet troops in Poland. Although there is, after all, communication by sea, so it is not impossible.

As to the second question, this is a very complex mixture of legal and political considerations on the part of Kohl and the West German government. Legally, according to the German treaty, the treaty between Germany and Poland in 1972, according to the Paris agreements with the West and indeed, according to the Potsdam Agreement, the final borders of Germany are to be determined by a united Germany at a peace conference. That is the legal status.

This has been reaffirmed in a decision by the Federal Constitutional Court. Nevertheless in the West German-Polish treaty in 1972, the borders were recognized de facto with the only reservation that they could not be recognized de jure because of the lack of an all-German government.

On the legality of it, it would be difficult, if not impossible, in German law to challenge Kohl. But, of course, law is not everything. Politics at the present time—indeed, at most times—is considerably more.

I think that the political reason why Chancellor Kohl is so reluctant to do this, although he has come very close to it, but interestingly enough mostly outside the Federal Republic, is his fear that he would be as a result helping to get the radical rightist Republicans into the federal parliament in the next election if they get 5 percent.

Mr. **Obey**. God knows we do not want that to happen. [Laughter.]

Mr. **Griffith**. If they get 5 percent of the vote throughout the country, they will get into the federal parliament. If that happens, the present coalition cannot continue. It will not have enough votes. Kohl knows that, and that is his problem.

Now, at the present time the polls in West Germany are showing that the radical rightists, the republicans, are around 3.3 percent, and that is what they got. But that would not get them into the Parliament. Kohl is trying to steel their thunder by being so to speak more for reunification than they are.

This is the political consideration from Kohl's point of view. I think that he must be an absolutely firm believer in your former speaker's view that all politics is local politics, because that is what Kohl is about.

Now, I personally think that it should be possible after the election in East Germany on March 18 that there should be a joint declaration by both parliaments, as there has been a declaration by the West German parliament, again declaring that they would, when unity comes and with the support of the four powers, guarantee the Polish-German border de jure. And it is generally thought that this would then be ratified by the next summit meeting of the CSCE, which is scheduled for November of this year. This, I think, is about where the present status is.

Those of you who saw the President and Chancellor Kohl on television on Sunday, undoubtedly noted there were certain differences in their views on this subject. I think that the basis of Kohl's difference has much more to do with his desire not to have the Republicans in the government than anything else. That is not something that is fully understood and certainly not appreciated in Warsaw.

I think that in the two plus four negotiations when they come to the fore, there should be at some point some participation of the Polish government in the discussions which would lead them to de jure ratification of the present boundary between Germany and Poland.

SOVIET DOLLARIZATION OF TRANSACTIONS

Mr. OBEY. Ed, you mentioned the problem of the Soviet "dollarization" of transactions. Will you go more deeply into what you think we ought to say to the Soviets and the time frame you think there ought to be on that process?

Dr. HEWETT. Well, I think we need first of all just to call attention to the fact that it is happening. We are so delighted about the notion that the Soviets are withdrawing economically and militarily that we are not thinking about the additional impact on the balance of payments that could come.

I mean, if you think of the picture Jeff is painting in Poland and add to that the shock that could come if suddenly, literally overnight Poland or Czechoslovakia or Hungary are asked to pay in dollars for all of the raw material and fuel deliveries and to compete with Koreans or with other European producers to sell manufactured goods to the Soviet Union for dollars, you know you would add to what is already a crisis in those countries.

In terms of the way we should approach it, I think we need to approach it through the East Europeans. Clearly there is a problem here. The sooner they get off this dole—that is, relatively cheap raw materials and fuels—the quicker they will institutionalize the pressures for economic reform. In a way it is like a drug addict. The question is how quickly they should come off.

We need to sit down with the Soviets, and the East Europeans, to work out an approach on this. This is not just a Soviet affair because if they do it too quickly, it is a bill that will be presented to us in our effort to avoid a crisis in Eastern Europe. We could suddenly be faced with another $10 billion that we would have to come up with, $10 or $15, depending on how you count it. We do not have much more leverage with the Soviets on this. If they say in the end, we are leaving, there is not a whole lot you can do about it, but it is worth a try.

TECHNICAL ASSISTANCE

Mr. OBEY. On the question of technical assistance you talked about the lack of coordination and the "Inundation" that is occurring, would you expand on that and in addition to the comments you made about the need to establish a more formalized group to do what Larry Eagleburger and others are doing right now.

Would you tell me what you think the Congress should focus on principally with respect to coordination efforts on technical assistance?

When I talk to people about Eastern Europe I see what Jeff Sachs is seeing: relatively small amounts of money which could be provided not just by the United States but by Western Europe, would have a tremendous impact.

A case in point: I would like to start just summer schools in economics in these countries, bringing in young people from the United States who have done everything but their dissertation, have them each a two month's crash course in economics.

You could also——

Mr. Obey. To whom?

Dr. Hewett. To young students in these countries. That is, offer the courses in Prague or in Budapest, in the countries themselves.

Take some of the brightest people in these summer courses and maybe bring them to graduate school in the United States. My particular interest is economists, but you can think more broadly in the areas of public policy. Aside from the real crisis they face the next few years, we must begin building a cadre for the next century.

It is relatively cheap. It is the sort of thing that if we had someone who was focusing on it, with the flexible money Jeff is talking about, it would be easy to do.

My complaint now with our government is that we have "backed into" assistance to Eastern Europe. Deputy Secretary Eagleburger is in charge of the process, on top of all his other duties. There is no identifiable, separate entity with its own budget and staff. There is no one in a high position who is spending full-time worrying about the problem.

I am reminded of a friend of mine from the University of Texas who was Secretary of Labor once, Ray Marshall, who said "when I want something done within the Department of Labor I pick a person whose only job is to do that and who is fixed on doing it, and I do not want him thinking about anything else. Then it will get done."

We have not done that in this case. For some reason we are afraid of the problem. But I suppose, I do not know exactly how to set it up. You guys are much better at this than I, but I would think about some sort of a commission or a committee that would have representatives from the Executive Branch, Congress, and the private sector, with a prominent American such as George Shultz at its head.

How you would actually give them money, I do not know. In the case of the Marshall Plan, we were quite creative, and much of what we relied on was outside the government; that is, a joint effort with the private sector.

If there is a will we can do that again and with that will and with some flexible money, we could have a bigger impact that we are having now.

We have some very good Foreign Service Officers working on this problem now, who spend hours every day trying to get together the various departments and their various budgets and their various interests to do little things. It should not be that hard to do something now, and would not be if we gave the effort the priority it deserves. This is not something that is going to wait a couple of years to work out. It is something we should be working on right now with Poland at the top of our list.

EUROPEAN DEVELOPMENT BANK, COMMERCIAL BANKS, AND DEBT

Mr. OBEY. Jeff, I have two questions. First of all, the entire Third World debt problem has suddenly become an even larger one with the addition of Eastern Europe to the plate. What should our policy be with respect to the creation of new Eastern European Development Bank? Do you think that is what we ought to be involved in? How do you tie that to the existence of the debt problem? With respect to Latin America, many people are concerned about simply pouring in more debt when you have that debt overhang. Would you prefer to simply eliminate the pretense that the debt is going to be repaid and drop the issue? Would that be preferable to dealing with the new recommendations on the Eastern European Bank?

Second, I have a different question. It does not relate just to Eastern Europe, but it is a similar issue. Last year, as you know, this Committee declined to provide the callable capital for the hard loan window at the World Bank because we felt that the administration was not getting enough cooperation from commercial bankers. In the process, we were simply creating a Rube Goldberg situation where we would contribute money to the banks, the banks would contribute money to the Third World countries, and the Third World countries would pay it back to the American banks. Do you think the situation has changed? Would we be better to now release that money, or should we keep the pressure on and try to get more bank cooperation with the administration?

Dr. SACHS. Two very good and difficult questions, but let me try my hand at them. The EBRD, this European Bank for Reconstruction and Development, is a problematic initiative in certain ways, and I have mixed feelings about it.

I think the essential problem is that if you look at a heavily indebted country like Poland, where it is already drowning in debt, the idea of taking new long-term loans on board without having solved the initial problem of the debt overhang concerns me a great deal.

One of the reasons why Poland needs to go for official funding right now is that because of the first $40 billion of debt, no private creditors will lend Poland money.

So we get into a situation where a bank proposal like this comes along because only official creditors will put in money now, given the bad old debt, but we don't really solve Poland's long-term financial situation because we just take the $40 billion and perhaps make it $50 million of debt, and keep the country under the shadow, or worse, of an unpayable debt burden.

It seems to me that if we go ahead with an initiative like the EBRD, it must be in conditions in which the old debt problem is solved, and perhaps the bank can play a useful role to some extent on a country by country basis, in helping to solve the old debt burden.

For example, the EBRD could be an appropriate vehicle to lend Poland the money that it would need to buy back its commercial bank debt at a deep discount. So one could think that the Brady Plan solution could work in part through a loan from this organization, to solve the commercial bank problem, perhaps buy it at 17 cents on the dollar which is its current secondary market price, and buy up the whole stock of debt and be done with that part of the problem.

I think the deeper problem though is, the bank debt may be solved because we have a Brady initiative, and I will speak to how well it is functioning in a minute, but we have the official debt which does not have a solution right now, and Poland's official debt is $27 billion.

I am stuck with the problem that while I would love to get more resources into Poland right now, and surely they are needed, doing that on top of this existing debt burden worries me a great deal.

Because what Poland needs is a fresh start and a future, not an endless period where it is not creditworthy and an ongoing period of having to beg for official funds, because it is unable to attract private funds because 40 years of communism happen to wrap up in a truly bankrupt situation.

So I think that my general answer would be that this bank can provide some useful financing if it were to come in a context where the existing overhang of debt were seriously, deeply, realistically restructured, as I noted was done for Poland's leading creditor, now almost 40 years ago.

Without that, I am worried about the initiative, and I see this as a real dilemma, not just for Poland, but for Hungary as well, which needs some restructuring, while its per capita term is higher as a proportion to exports and income, it is marginally better than Poland's situation, though it is serious.

We have seen politically how it is already destabilizing the place, and to a even lesser extent for Yugoslavia. So I am worried, that we have not really thought through how that bank is going to help solve financial problems if it is only going to pile on new debt on top of the old.

Let me speak more generally about the debt situation, since you asked about the World Bank appropriation. You were very wise last year to put pressure on the bank and on the administration to come up with something more serious. Frankly, I think that the time is not ripe to let up on that pressure because the Brady Plan is still a plan without rules and very much a muddle through plan that only works when you happen to get the undivided attention of the Treasury to twist arms in a voluntary way, as they like to say, to twist arms to solve a country's problem.

We did that for Mexico because of the obvious importance of Mexico to the United States. We did that for Costa Rico, both as a reflection, like with Mexico, of good internal economic reforms and vital importance for foreign policy.

But, for the rest of the world, this plan is totally stuck in the mud and not going anywhere. They like to say that the Philippines got a plan, but if you look at the details, it is a disaster, not a plan. It does not really reduce the Philippines' debt.

We talked them into doing a minimal thing so they could add it to the list of countries that they checked off, but we are farther from solving the Philippines' debt problem than we ever were before and this is a step backward, not a step forward.

Then you have countries like Venezuela which is under terrible pressure, Ecuador, Peru, Bolivia—Bolivia, which still is yanked around by Citibank unmercifully, and so forth, where the Brady Plan doesn't function.

So, I think that your point last year was right. How can we give money when we do not have a solution? It is like the EBRD problem but this is for the IBRD. How can we give new money, when you really have not told us seriously how you are going to solve the old problem and we do not want our money just channeled to pay banks or to pay bad old debt.

I think the same—what we have learned about the Brady Plan, I use "learn" loosely because we knew it beforehand, is that volunteerism in debt relief does not work. A voluntary approach for debt relief makes as much sense as a voluntary bankruptcy proceeding.

I have never heard of anyone go into a bankruptcy court where the judge said, okay, every creditor here who voluntarily wants to write off his debt raise your hand and the rest can leave.

It does not work that way, and yet this is the idea of the Brady Plan in words, although everyone of us that is a participant in it, knows that what volunteerism means is just a behind-the-door arm twisting until the Treasury gets its way. There is nothing voluntary about it, it is just out of the light.

But since the Treasury is trying to operate without rules and in a totally ad hoc fashion, this plan only works marginally at best, and only in those cases where Mr. Mulford or Mr. Brady devote a lot of attention.

So unfortunately, we are not much better off than we were last year. I think that this Committee's position was extremely helpful in focusing attention, but now I think to see it through, you still have a problem, that the Treasury has to show on a rule-based method how it is going to move forward now and solve that problem.

Mr. OBEY. Let me apologize, I forgot that Ed said he had to leave. He has about five minutes left. Jerry, let me ask you and Matt if you have a question for Ed. Why not ask Ed questions first, and then I will get back to you right away for questions for the other panelists.

Mr. LEWIS. Thank you. But frankly, the questions that I do have affect all three, so I think it would be better if the others specifically addressed Ed.

Mr. OBEY. All right. Matt?

WEST GERMAN DEBT RELIEF

Mr. MCHUGH. Well, this could go to all three, too. But, Ed, before you leave perhaps you can address it. It's clear that the Federal Republic of Germany has a critical role to play here, but listening to you all discuss it, it seems to me there is a question as to whether or not we are expecting too much.

Bill, you said, if I understood you correctly, that in dealing with East Germany with all of its economic problems and where West Germany is going to clearly have a primary focus, there will be deficits and high interest rates in order to avoid inflation and so on.

And then when talking to Jeff about the debt problem, you indicated, correctly, that a lot of this debt, public and private, is with West Germany and that in order to get rid of the overhang, West Germany should be pressed to relieve this debt, cancel it all, or at least some of it.

In the aggregate, are we expecting too much of the Federal Republic of Germany? What are the implications for that country if we do—if it does all of the things we are expecting it to do?

This is something which others may address, but Ed, you may want to——

Dr. HEWETT. Well, that is such an easy question, I will let the other two handle it. [Laughter.]

And I apologize that I have to leave. [Laughter.]

Mr. MCHUGH. We will have a special session with you then.

Dr. HEWETT. All right.

Mr. OBEY. Thank you, Ed.

Dr. SACHS. Would you like to start or shall I?

Mr. GRIFFITH. Well, I will only say that there is no question that the Federal Republic will now give priority to East Germany over changing the Polish debt situation, because it is going to have to, for all kinds of reasons, primarily, to stop this influx of 3,000 East Germans per day into West Germany, which would bankrupt the West German social security system very rapidly.

It is going to have to aid East Germany with probably a deutschmark union within the next few weeks before even political reunification—to a point where undoubtedly the Bundesbank will raise interest rates.

Now compared to that, which is a clear and present danger to the fiscal stability of the Federal Republic, I just doubt that they will, on top of that, cancel the Polish debt all that rapidly.

But I think something can be done, and I think that we should urge them on this. However, it is somewhat difficult to urge an economic issue on the Federal Republic, when it had last year a favorable balance of trade of $80 billion and ours was somewhat less. [Laughter.]

Dr. SACHS. Your question is one of the few questions regarding the region that I lose no sleep over. We are creating or this German reunification is going to create an industrial powerhouse unrivaled in Europe, of enormous, overwhelming productivity, trade strength, industrial power and financial strength.

What has happened in the East has strengthened German economic potential enormously. There are short run burdens, and I have stressed that the problems in the region are short run transition problems because there will be economic growth in the region.

They have been performing so far under human potential, that there will be growth if the transition is successful. I think that there is going to be a boom potential for Germany as the central economic power of Europe that will allow them to undertake huge, new investments throughout the region. German economic strength and influence in the region is going to be multiplied.

So I do not really worry about that issue at all. On the debt, it must be understood, if the import of your question is that somehow Polish debt payments will help the German economy, one should stress, first of all, they do not take anything from Poland right now but they also do not solve Poland's problems.

What they do is they say each year we will take a little bit and next year you owe us, and by doing that it is not really even giving them any resources, although the idea that somehow Poland would help bail out West Germany is not an idea that I would take as a serious financial one.

Poland is not really paying right now, but it is still suffering horribly from the debt overhang, and that is the irony of this kind of debt situation.

High German officials tell high Polish officials all the time—we know that you cannot pay, you know that you cannot pay, let's just not talk about it.

That is not a solution for a country. That is not serious. It is not a solution for a corporation and that is why we have bankruptcy. It is not a solution for an individual in bankruptcy. We need a discharge to give a fresh start.

It also has never been a solution for a country because if the country is going to get new investors, new trade relations, new suppliers, new commercial relations, it must have a prospect of macroeconomic stability. The overhang of bad debt cripples the effort to create a stable economic environment. The Germans could afford this without even losing a penny or pfennig of actual cash flow.

The strength that would result from Poland will rebound to them anyway, so this is very much in their interest, once they break through the mindset that this kind of thing can be done. And, the way for them to break through the mindset is to remember, for heaven sakes, that they are the classic case in this century, of the danger of not doing it, which is what happened in the 1920s when we rolled over the debts that Germany owed in the Young loan and the Daws loan and finally they were so economically crippled that it contributed to the rise of Hitler.

We saw in the 1920s what happens when you do not take this seriously, and in the 1950s we saw exactly the opposite. It is one of history's closest economic experiments one can find. In 1953, we did the opposite, we gave them very generous terms.

Now it's their turn to lead. They can so easily afford this without batting an eyelash and never noticing the difference except that they will have an economically stable and growing country on their border.

We should not only not lose sleep over pressing this, we should recognize that this is one of the most important things that we can do at virtually or literally no cost to our treasury, but it could make a profound difference for Poland's economic future.

Mr. Obey. No real cost—only a pretend cost?

Dr. Sachs. Only pretend costs. I talked to Treasury officials last week before they went off to the Paris Club and they said, we know, we agree with you, but we are not going to do anything because Prime Minister Mazowiecki had asked for a more serious treatment, and the Treasury said, well, we cannot really do it.

And I said, you know you are not going to collect, and he said, of course we know, we have known for years. I said, well, why not make a future for Poland then? Well, "it's hard," et cetera, et cetera.

So in terms of real cash, this is a way we can do it without expense and it will save us official lending in the future because the private sector will go in there and do the lending that otherwise we are going to have to do.

Mr. McHugh. Well, it sounds like a very compelling case. You make perfectly good sense to me, but as the Chairman has said, and as you know, this Subcommittee has been trying to get the Treasury to press our commercial banks to do this, but there are no volunteers except when their arms are twisted, as you put it.

The same reaction apparently is taking place in Germany from what we can see thus far, unless you can tell us something more reassuring.

Dr. Sachs. Let me say that in my discussions with German officials, there is a good recognition of the need for this kind of thing. But this is essentially a political decision and it requires heavy political involvement, which has not yet occurred.

And German bankers, by the way, which are the major creditors, a major economist from a major German bank assured me a few days ago at a conference in Europe: Do not worry, the German banks understand it, they will not be the bottleneck to this.

Mr. Obey. Jerry?

DEBT OWED TO THE SOVIET UNION

Mr. Lewis. I have just a couple of questions that perhaps both of you could respond to. But first, maybe you could help relieve me of a kind of preconceived notion evolved from the early stages of this incredible change in Eastern Europe.

Before any of us actually could get ourselves to believe that this was going to happen, at a breakfast meeting, Barber Conable, in a private discussion was talking about pressures on the World Bank to take a look at those Eastern European countries, I thought he presumed that a large amount of the debt, the foreign debt of those countries was debt held in Soviet currency to the Soviet Union.

Your description of Poland certainly would suggest that that is not the case and the follow on to that was what kind of heat will the World Bank get if it is delivering money to East European countries that essentially will become a subsidy of the Soviet economy.

I gather that that presumption was not an accurate reflection of that debt?

Dr. Sachs. No, no, that is completely not the case.

CANCELLATION OF OFFICIAL DEBT

Mr. Lewis. As Matt has said, your description of official debt as well as pressure on banks, especially today, official debt cancellation, if you will, is very beguiling. But can you both give us some of the arguments against such a write off, if any? Not just on the part of Germany but others too.

Dr. SACHS. The argument against the write off of Polish debt has nothing to do with Poland. It comes to the question of Argentina. That is what you hear. The question is never in any of these discussions do you hear a serious discussion of the issue at hand.

It is a discussion of what it means for precedent, if anything, and what would happen next and who else and so forth. These are to some extent valid points, although we make distinctions all the time, it may be that a different country also needs official debt. And I think that that debt relief and that should be examined.

We have a policy of official debt relief to a very, very modest extent for some sub-Saharan African countries. No one that I have met in a year, Mr. Congressman, working on Poland, ever said, oh, they could pay, what are you talking about. The argument is always to find some other case that may be completely irrelevant, but it is certainly not satisfactory for Poland's future to say that one thing or another cannot be done.

I am afraid I have been living with that for years as a main economic advisor to Bolivia, where it was recognized. And this is just as a sidelight to give you the sense. This is a country where 300 infants die per 1,000 live births in the country side. It is truly a human tragedy beyond what we know.

And, yet Citibank has refused to give any debt relief for this country with a smile and always the arm around the negotiator saying, we believe in you, we will stick with you. That is because Bolivia happens to have the sad feature of being on Brazil's border, sad in this respect, and so nothing can be done that is an example. No one ever talks seriously about Bolivia's needs in this case.

So I am trying to focus on what Poland needs. It is clear, and I think given the scope and scale of reforms and our stake in this from a security point of view, a military finance point of view, a commercial point of view, commitment to freedom, and on the straight financing and economics, there is no doubt that this is needed to me.

Mr. LEWIS. So what you are really saying is that the only serious arguments—if they are serious—involve precedence and the impact that it might have on other parts of the world, rather than any reality?

Dr. SACHS. That is my feeling very strongly.

Mr. GRIFFITH. And I entirely agree. We want Poland—this Polish experiment—to succeed from almost every point of view. We on the other hand constantly encounter arguments of the kind that Jeff Sachs has been saying. Oh, what would this do to Brazil and Argentina? Well, that is not really the point. It is even possible that the Poland experiment is more important to us at the present time than whatever happens in Argentina.

You can be sure that whatever happens in Argentina, it will be bad.

Mr. LEWIS. It will screw itself up.

Mr. GRIFFITH. That is right. [Laughter.]

Furthermore, I agree with the view that was expressed, I think, that not only will it not cost us much money, but that the Germans know very well that they are not going to get paid. It is in their interest to have the Polish experiment succeed. I do not think there is any question about that.

Dr. SACHS. Absolutely.

Mr. GRIFFITH. But the problem, I would guess, is in the sheer amount of time in Bonn which is put in now on East Germany. There is not much time left over at the top—political level to do anything much about Poland. They will argue, well, we just gave Poland in one way or another 2 billion deutsche marks.

Dr. SACHS. It was in another way, not in the one way.

Mr. GRIFFITH. I know, it was in another way. It was essentially in insurance guarantees and so on for German private industry. And the obstacle for that is just what you said.

But, nevertheless, it would be strange if you would expect at exactly this juncture, when the financial future of West Germany is so deeply tied to what happens in East Germany, if you would have a lot of West Germans saying, oh, no, we should not be so concerned about this; we should be more concerned about Poland. They just will not do that at the present time. But that is not any reason why we should not keep on trying to press them to do it.

COMMERCIAL BANK DEBT NEGOTIATIONS

Mr. LEWIS. Mr. Chairman, before I run out of time, I appreciate the responses, but may I get to my second question.

I went to the signing of that debt agreement in Mexico with the Secretary of the Treasury. One of the more intriguing things was to note the pain on the face of the financial people who were at that head table as they were signing the agreements.

Nonetheless, I really agree that we should play a role putting pressure on the banks to play at this table. Was the Mexico model a good model? Is it likely to be a model that will move forward in the real world? And beyond that, if you could, help me with another bottom line question that bankers would raise, which is, when do we reach a crunch point that would suggest that too much pressure might very well break the bank, if you will?

Dr. SACHS. Those are good questions. I think the essence of what is wrong with the Mexican agreement and with the whole nature of negotiation is that it is not based on the financial needs of the country in question. There is a tremendous and a dramatic break between the technical analysis and what goes on in the negotiating room.

You know, the IMF actually makes forecasts about financial needs and capabilities. These are about the best that are around officially, even those are influenced perhaps by creditor needs or interest and so forth. But, what they tend to show is the unpayability of the debt. And they can be used as a basis for judging how much debt relief is needed, or how much debt reduction is needed.

That is what a bankruptcy court would do also. It would be to examine the cash flow situation and make a judgment on some ground rules and analysis of what should be done. But, what happens is the IMF does that kind of so-called medium term balance of payments projection. Then totally and completely differently, the finance ministers are thrown in the room with the bankers and say, okay, you guys voluntarily work this thing out.

And, the two actions are not linked. They are not linked to such a ridiculous extent that in the Venezuelan case, it was shown in the IMF agreement that Venezuela could not afford to pay above a certain amount of interest. And the banks said, well, garbage. We do not respond to that. And, they were put under pressure to pay a lot more. Finally, the IMF came in and countermanded its own findings and pressed the Venezuelans also to join in on paying above what their means were. Then, Argentina had to file a waiver to the IMF to explain why its reserve position was less than the program promise, because the IMF staff had forced them to pay more than the IMF staff had even said was possible.

In other words, it is a little bit Alice in Wonderland. The main problem with these negotiations in all of the countries is that there is no sense of saying what does the country need, now let us structure an agreement to get it done. That is not the question ever asked.

The question asked is what can we get from the country side, and from the bank side is, what do we have to give right now and is Mr. Mulford pushing or not pushing. What is our real negotiating leverage. Does Bolivia happen to sit on the Brazilian border or not and so forth.

So this is not a rule-based method, and it is not an analytical method where you try to say, here is a kind of solution that meets these country's needs. That is why the Philippine solution is to reduce their debt by 5 percent or something. This is what that agreement amounts to, because no one took a serious look and said, what will really solve this country's problems.

Rather, they said, we need another agreement on the list of the Brady plan checklist of countries that have gone through the process. So you get an agreement, but it does not solve the problem.

In Mexico, most analysts felt that a 50 percent reduction of the debt burden was what was needed for a solution to Mexico's problems. If the Mexicans then went ahead and did monumental reforms which they actually seem devoted to doing. Instead that was an IMF kind of analysis, and it was very much an independent analysis.

But, that is not how the negotiations went. This is the problem with "voluntarism." It is arbitrary. It is dependent on the personal involvement of Treasury officials rather than being rule-based, it depends on what is particularly on the agenda of the moment.

And, therefore, we have three cases, one of which is not even a case, since last March when this plan was unveiled. I think that is the basic problem.

Mr. **Lewis**. What about breaking the bank? If you look at the whole world?

Dr. **Sachs**. Well, if you look at the whole world now and look at the banks the overwhelming thing to remember is that the banks are fully reserved for losses far greater than anything they are being called upon for in these settlements. They have already taken the hits.

You hear major bankers all over the world say all of the time, this problem is behind us. It is behind the debtor country, it is behind them, because they are fully reserved to take twice or three times the size of the hits that are coming out of these agreements right now.

This is not a banking crisis. It has not been a banking crisis for a few years. It was a banking crisis once, but it is no longer a banking crisis and not even close. There are no major banks that are threatened by this. None.

Mr. Lewis. Can you, for the record or for me, supply some background, some commentary on this?

Dr. Sachs. Yes, I would be delighted. And one thing I would supply you with is the statement of William Siedman last year on the panel that I testified in the House Banking Committee, where the Chairman of the FDIC said, the largest sixth debtor countries in the world could wipe all of the debt off the books without involving the FDIC for a penny.

So this is not a banking issue at all. This is a matter—it is a banking issue in the sense of power negotiation and the absence of rules and the absence of logic and the absence of economic input, and the disjunction between the technical work of the IMF and what goes on in the negotiating room. But it is not a banking issue in the sense that you were talking about.

Mr. Lewis. Thank you, Mr. Chairman.

Mr. Obey. Go ahead.

MANDATING COMMERCIAL BANK DEBT RELIEF PARTICIPATION

Mr. McHugh. Just to follow up on that. The opposite of voluntarism is mandate. What form would these mandates take to require the commercial banks to be more forthcoming?

Dr. Sachs. I think that there is a ready mechanism at hand, and that would be to put the IMF in the position of making judgments about capacity to pay. I would be willing to take the gamble, because it is our professional institution whose responsibility is the stability in the international monetary system.

What I think they could do is, based on medium term balance of payments scenario, come up with an adequate analysis of the kinds of things that are needed for a real program of relief. And, then the IMF could insist that that be an across the board settlement of all creditors in a particular class, lik~~e a bankr~~uptcy proceeding. Not have one bank say, oh, no, no, no, we do not do it; we insist on no loss for us and have the next bank say, well, we will do a little buy-back. And, have the next bank say, we have a special deal, we want that hotel over there.

That is not how bankruptcy works. Bankruptcy works by saying here is a settlement that makes sense. Here is an agreement reached across the board. The IMF could provide precisely what Mr. Brady told them not to do. Provide the input for the kind of settlements that are needed. Then, the banks would be required to come up with that. If they do not, the IMF has the stick to put this in place. It is the so-called Article VIII, section 2(b) of the Articles of Agreement.

What it would basically say is, if the country does not get the formal agreement from the banks, that under the IMF's umbrella the country is only obligated to pay up to the amount of the agreement as the IMF saw fit.

Under the Articles of Agreement the country would no longer be subject to legal challenge by virtue of the protection given by this international agreement in which all of the member countries and the courts of New York, in particular, are bound to obey the terms of the IMF.

So one can see a mechanism. I do not think it would have to get into this legality in the end. What we need is a serious statement. This is what this country needs to get going again. Now, let us have all the banks do it and put it in place and stop the fig leaf, or the figment of imagination of voluntarism and so forth, which is proving—as all predicted it would be—to be the impossible barrier to get this going.

You know, we have in Venezuela right now a case where one major commercial bank is saying, no, just forget it, forget it we are not doing it. And, it has caused months and months and months of negotiation, not at all with attention to the needs of the country.

TECHNICAL ASSISTANCE TO BUSINESS

I wonder if I could sneak in one more statement to come back to a question that you asked. Mr. Hewett, if we could return to Eastern Europe for a moment on the question of technical assistance and coordinating technical assistance.

I think it is important to keep in your minds two different kinds of technical assistance. One is sending experts, advisors and so forth to do analyses. And that is important, sometimes useful. And, I think it is one thing that people think about.

I am talking about something quite different when I talk about technical assistance. Maybe it is a misnomer to use it, but I am talking about business assistance. That really is getting these firms plugged into the world business system.

The U.S. has a wonderful industry of management consultants and accountants and others, which in the context of Eastern Europe nothing is more vitally needed than those kinds of people right now. But, they come with a price tag. It is getting in that talent quickly.

I hope in fiscal year 1990, not just fiscal year 1991, frankly, because Poland is sliding into a recession right now, and we have to get the goods out into the markets so that this program is stabilized. For that they need the contacts in the business community. That is the kind of assistance that I am thinking of. The way to get it going is not really for us to have individual projects on our end deciding what it is that the Poles need.

We have to be flexible to let have this designated for the purpose of under the broad rubric of bringing in this kind of management expertise and accounting expertise and business leaders, corporate law expertise under a fund managed by the Polish economic team under the fund managed by the Polish Government.

But, I think it should be in conjuncture with the IMF program, so it would be in consultation with the International Monetary Fund for example. But, this should be done quickly and generously. And, as I said before, I think the returns even to our business community would be enormous. The returns to Poland could be quite fundamental.

Mr. McHugh. If I understand what you have proposed, it is to establish a fund which would be under the economic ministry or the finance ministry, and they in turn would then hire consultants to come in and work with these firms, these 7,000 firms?

Dr. Sachs. Yes. What I have in mind—and this is very sketchy, since we are at the beginning of the process—what I have in mind is that the Polish Government would make clear to these firms, you have monies available; you have to contribute half, for example. I would like to see it roughly that the firm would have to spend half of the money needed.

The Polish Government would put in a quarter perhaps and our money would supply a quarter so that we would leverage it up. We would make sure that these firms are going to use these resources properly, because they would be putting in their own money also.

We would leverage up our resources, and it would not be a centralized decision. It would be a decentralized decision. The firms would be instructed to go out and get help, especially, potential exporters go find your markets, go find your inputs and your outputs and marketers and management assistance and so forth.

And, as a general means, this is the way we can help reactivation. Because the other kind of pressure for reactivation is going to be spend more money, raise wages, ease the money supply and put them back into a hyper-inflation.

So this is a way to do something real, to find a real change of quality of management and connection to the world and partly to avoid what will be very tough pressures on the Polish Government to try the easy way, which we can guarantee will not work and will send them back into financial instability.

I should say—and it is important for you to know—that they have taken heroic measures at the beginning of this year. They are having strong and positive effects. The inflation which was about 80 percent for the month of January alone is estimated from February 1 until the end of February to be about 2 percent for the month. They have broken the back of the hyper-inflation.

This is a decisive turn-around in this economy. This is the beginning of something wonderful. Now, we must help to see it on course, and I cannot stress to you the urgency of getting appropriated funds so that they can get this process of reconnecting to the world going in this year.

Mr. McHugh. I have another one or two quick questions, Mr. Chairman.

Mr. Obey. Go ahead.

THE POLAND PROGRAM AS A MODEL

Mr. McHugh. What about the other countries in Eastern Europe? Are they waiting to see what happens? I mean, obviously, there are different circumstances in each one. Poland has a critical situation though. Are the other countries waiting to see what happens in Poland? Should they be moving more quickly? If so, what can we do to help there?

Mr. Griffith. Well, I think that they are waiting. In Hungary, I think that the situation is rapidly approaching something similar to Poland. And they are different, one from the other. They are also different in terms of the amount of American money that would be required.

But I think, Jeff, you know much more about it than I do. Why do you not take over.

Dr. SACHS. I think in a general sense Poland is perceived to be trying the dramatic approach—the jump to the market. It is doing it under the handicap of the starting point, which was a massive debt crunch and hyper-inflation.

Yet, it is trying to move very rapidly—more rapidly—than the typical kind of approach that had been efficient before.

In a sense other countries are asking, well, can the quick approach work. I recommended the quick approach not just because it is quick and will get them to a desirable place faster, but because I do not think the slow approach can work. Gradual reform which may sound safer and so forth ends up being worse, I believe.

It is the kind of failure that perestroika is showing right now on the financial side. The step-by-step approach rather cannot work for very good, deep, solid economic, financial and political reasons. You get trapped both economically and politically in a mass of contradictions.

If the Polish program were to go down, I do not know what model exactly one would have except paralysis. Because, in a sense, gradualism has proved to be a dead end. Hungary has been reforming for two decades. And, it has ended up in a terrible catastrophe.

I think who is watching Poland more than anybody probably is the Soviet Union. Because that is a case of profound financial destabilization, where they are going to take some quite radical financial medicine of the sort that Poland has embarked on at the beginning of this year.

THE YUGOSLAVIA PROGRAM

Yugoslavia—let me say a word on that. I am serving as an advisor to the prime minister. And, they have also taken very bold steps at the beginning of this year. We hear less about it, and what we hear about Yugoslavia has to do with Kosovo much more. They introduced in Yugoslavia a full convertability of the currency pegged to the Deutsche mark, a dramatic liberalization of trade and a dramatic freeing of the property structure.

So they are also embarked on a quite dramatic program. But, I would say whether Poland shows that it is possible to jump to the market, which is the phrase that is used, or not, can have a decisive effect on reform results through the region.

EAST-WEST POLITICAL AND ECONOMIC INTEGRATION

Mr. MCHUGH. I have one other question, and this is a big question. I am not sure anybody can answer it effectively. When we talk about reunification of Germany, there are the various scenarios presented as to how that could be accomplished politically.

A neutral Germany is what Gorbachev apparently talks about. What you said earlier, Bill, about having the new Germany within NATO but some arrangement with respect to troops and no western troops in Eastern Germany.

When Havel was here, he talked about a Germany which was very much part of a united or integrated Europe. That means east and west, so that Germany would be anchored in a total European community.

There is a similar question with respect to economics. Can the east, as it evolves, be integrated economically as well as politically in some way with the Western European countries? And all of this, of course, in the context of Europe 1992.

The big question is, what do you see as the most feasible outcome, between now and 1992 or 1993, evolving here both economically and politically?

Mr. **Griffith**. Let me take the political part. As far as the present West German Government is concerned, I do not at all share the fear that it will so occupy itself with the unification with East Germany that it will abandon or pay less attention to 1992.

As a matter of fact, if anything it will pay more attention because of the very simple reason that it will be one of the great profiteers, probably the profiteer of 1992, as Jeff Sachs said, because it is going then to be the strongest power in Europe, much stronger than it is now. After this intermediate period where there will be strains on the deutschmark, there will be a boom, and the center of that boom will be a united Germany. Of that, I think there is no question.

I, therefore, do not think that the fear in this country and the West that in some way the unification of Germany is going to wreck 1992 is justified. I do not think it is really the case at all.

As to the economics of it, I think I should not talk about that.

Mr. **Sachs**. Let me say one word, concurring in everything that you have just heard—there was a lot of good economics in there so you (Mr. Griffith) should just continue probably.

There is a question of the institutional nature of the link between the Eastern European economies with the Common Market. This is a complicated issue. Let me try a couple of points.

I think there is nothing more vital for the success of these reforms in the long run than a full integration of these economies within a European common economic space and expanded economic space. That means free trade, free movement of labor, free movement of services and capital ideas, managerial and organization skill and so forth.

Eventually one can envision a broadening of the scope of the European Community in some form to encompass all of the democratic market economies of the region. In the short run, there is a large problem, and that is that the European Community is integrating not only economically but also politically.

There is a strong case, I would agree with the EC, that the process of 1992 should be completed and the unification really made solid both politically as well as economically before the Community can be dramatically expanded. That means, however, that membership for the Eastern European countries is probably not in the cards in the short run, although membership for countries now out of the Community for a couple such as Austria is probably likely to be envisioned and actually with the process being set up in the next couple of years.

In the meantime, it is important that these countries in Eastern Europe not just be left as outsiders trying to peer over into the wonderful party going on in Western Europe but, rather, that, short of full membership, very strong economic bonds be created.

What is being talked about as an interim pattern is a full association status for the East European economies that are in the process of market reform along the lines that now link EFTA, the free trade area of which Austria is a part, with the free community so that it would create an economic space but less of the political dimension.

Over time I think that the community is going to have to expand in one form or another over a period of 10 or 15 years to embrace all of this region in a far more balanced structure.

The one thing that worries me, which I do not think is a likely case but it is a worry, is that the Western European countries somehow try to keep the East out or make the terms of accession so unfavorable as, for instance, that agriculture would be restricted in sales or certain industries would continue to be blocked by nontariff barriers and so forth, that these countries could be severely hurt in the process.

We should be pushing the United States interest for an integrated European market structure, because that prosperity will help us considerably as well as the stability that will result. So we should be pushing in this regard that the European Community sign agreements with Eastern Europe quickly with the clear timetable that establishes a very tight economic link, if not a full political membership right now.

Mr. GRIFFITH. We would be helped in pushing if we could bring about what Secretary Baker proposed in Berlin, which is a closer institutional link between the United States and the European Community.

Mr. MCHUGH. Thank you.

Thank you, Mr. Chairman.

YUGOSLAVIA

Mr. OBEY. I have a couple of final questions.

Bill, on Yugoslavia, what is going to happen? Where do you think they are going to be in five years?

Mr. GRIFFITH. I do not know. Predictions about the future are, as we should have learned from the last year, not good.

Mr. OBEY. If you do not know, nobody does.

Mr. GRIFFITH. I doubt that the country will fall apart, at least legally fall apart, but I do not think that the struggle between the Serbs and the Albanians in the Kosovo will be settled. It has not been settled, in fact, in some 300 years, and it is not going to be settled in the near future. It is a running sore in the economy as well as in politics.

It may well be that the appeal of Milosevic in Serbia has passed its peak. Certainly it has among intellectuals. That is an encouraging sign. The fact is that the attraction to the Community of Croatia and Slovenia and their increased growth compared to the southern and eastern part of the county is pulling the country apart economically, culturally and in almost every other way.

The international influence of Yugoslavia, therefore, either in Western Europe, toward which it is now turning, or in the nonaligned world, which it has finally almost forgotten about, will continue to decline, and Yugoslavia will become, unfortunately, particularly if this economic reform does not succeed but even if it does, not a real basket case, probably, but close. [Laughter.]

Mr. OBEY. Well, that is wonderful news. [Laughter.]

JAPANESE PRESENCE IN EASTERN EUROPE

Jeff, you mentioned earlier the Japanese activity in Eastern Europe. Before we came in, you mentioned something about the Japanese presence there. I wonder if you would expand on that a bit.

Mr. SACHS. All right. We have heard in the U.S. that U.S. business is not moving into Eastern Europe because, after all, it is far away and it would be very hard to compete with the Germans, and so this is just an area of the world that U.S. business cannot get involved in.

If the test is distance, it fails in the case of Japan. The Japanese are all over Eastern Europe and are putting in enormous resources right now of analysis, study, contacts and the intention to invest. They recognize that Eastern Europe could be under the right circumstances, if these other things get done, an extraordinarily profitable export base into this expanded European space.

I have been told that the Japanese are on a first-name basis with the managers of all of the largest enterprises of the GDR and that they are not even leaving East Germany to the Germans, that they are intent on making major investments there.

The diplomatic immunity of the Japanese is very much involved in analyzing, studying and being active in trying to smooth the way for Japanese participation in these economies, and for these economies it is a terrific thing. One does wonder where is the U.S., however, and where is U.S. business, and why are so many businesses ready to cede this very large market with potentially very large possibilities to other countries. It is certainly not the Japanese approach.

Mr. OBEY. Well, I am struck by so much American concern, with 1992 coming up, that we would be boxed out of those markets—at least marginally. If we were to have the kind of American activity, even on a small scale, that you see with Japan right now in Eastern Europe, would that not give us an opportunity for entry into Western European markets through Eastern Europe?

Mr. SACHS. Well, without question, if these financial problems of the debt and the stabilization and the currency convertibility can be solved—and I think technically they certainly can be solved—then these countries offer a wonderful opportunity for investment, one would think. It is not just my view, it is the view of European and Japanese businessmen for the sake of manufacturing processes, intermediate processes for reexport or integration with the markets of Western Europe.

After all, a Polish skilled worker right now is making perhaps a dollar an hour or less with skills that are certainly comparable to his counterpart in Western Europe. It is a measure of how disintegrated the economy is, but it is also a measure of the up side of the great potential for very profitable investment and using Eastern Europe as a manufacturing assembly base for integrated markets.

I have talked to many European firms and, I think no American firms, on this point that are thinking about trying to buy in or make joint ventures with state enterprises in Poland and to convert those enterprises into part of an integrated worldwide or Europeanwide production system, taking advantage of the very low labor costs right now as meaning that Poland, under the right financial circumstances and with stability, would be an excellent base for production.

Of course, with all of the interest, they are doing a lot of study, and they are waiting to see whether the debt problem and the financing problem can be solved, but on the U.S. side you see even less of just the simple analysis of what the opportunities are.

Mr. GRIFFITH. The intensification of the Community 1992 was formed probably more against the Japanese than against the United States. It was the competition of the Japanese and the other East Asians which concerned the major European multinational corporations the most seriously.

The Japanese, on the other hand, realized not only that they can make lots of profits in Eastern Europe but that this is a way whereby they can get behind the Community and, so to speak, assault it tradewise from both sides. That is another reason why they are investing so much in Eastern Europe and why Prime Minister Kaifu suddenly announced this nearly $2 billion credit.

Just to give you one example, for several years there has been a team from Suzuki, a Japanese automobile manufacturer, in Hungary. They have now concluded, I think, an agreement whereby there will be, instead of the zero cars that were produced in Hungary before, 300,000 cars per year produced by Suzuki under, I believe, top Japanese management. I do not think that anything like that is happening in this country.

Mr. OBEY. So they are investing in their future, and we are counting beans under Gramm-Rudman. [Laughter.]

Gentlemen, thank you very much. It has been a very interesting hearing today, and we appreciate you coming.

WEDNESDAY, FEBRUARY 28, 1990.

NEW DIRECTIONS AND NEW PROBLEMS IN FOREIGN ASSISTANCE

WITNESSES

WILLIAM E. COLBY, FORMER DIRECTOR, CENTRAL INTELLIGENCE AGENCY

ALTON FRYE, VICE PRESIDENT AND WASHINGTON DIRECTOR, COUNCIL ON FOREIGN RELATIONS

EDWARD L. WARNER III, SENIOR DEFENSE ANALYST, RAND CORP.

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CHAIRMAN'S OPENING STATEMENT

Mr. OBEY. Good morning.

Yesterday, we began our hearings on the Administration's foreign aid request for the next fiscal year with a hearing specifically on Eastern Europe. Today is the second day of what I would call context hearings. We are trying to set the context in which we will be discussing the Administration's foreign aid request for the coming year.

Today's hearing is aimed at focusing on potentially new directions that foreign assistance ought to take, given the fact that we have seen some remarkable events, especially over the last year.

As I said in my opening statement yesterday, for the past 45 years we have been focusing our foreign policy primarily on anticommunism, based on the Soviet threat, which derives from the failure of the Soviet Union to essentially live up to the promises it made at the end of World War II. This meant that, while we served as the arsenal of democracy during World War II, we pretty much were serving as the guarantor of Western values and the guarantor of Western security for the 45 years after the end of World War II.

It was a costly effort, and there is a considerable debate about how we ought to feel about the results of that now. However, we are finally beginning to see the Soviet Union engage in the kind of conduct that we had hoped they would engage in for a number of years previously.

Mr. Gorbachev is focusing on internal reforms. His signal that the Soviet Union would not, in fact, militarily enforce the remaining in power of communist governments in Eastern Europe has led to the remarkable chain of events which we have seen in that region over the past year.

Much of the $15 billion or so that we are providing for foreign assistance has been justified as defending and promoting Western and American interests against Soviet or Marxist intrusions and domination around the world. Now it appears that the Soviet approach in the Third World may be shifting. Their activities seem to be less ideological and related more to Soviet geo-political considerations. Instead of focusing so heavily on Marxist outposts, such as Ethiopia, Mozambique, Vietnam and others, they seem to be focusing more of their attention on major regional players—regardless of ideology.

Administration witnesses testified last week that the Soviets have even indicated an interest in being conciliatory in a place such as El Salvador.

As a result of those changes, we have seen a multiplicity of suggestions about how we ought to change the pattern of our resource usage in this bill. I have personally concluded that as a result of all of those suggestions about use of the "peace dividend", we are going to see half of the dividend used for deficit reduction, half used for domestic investment, half used for new international efforts, and the other half get new mathematics instructors for everybody else. [General laughter]

Nonetheless, today we have a panel of distinguished experts to provide us with their observations concerning the political, military, and economic changes which are occurring in the world; to further provide us with their insights as to what those changes may mean for the future; the opportunities and obligations the changes present us with both for cooperation with the Soviets, and for further continuing and ensuring democratic progress in the world; and the way they ought to be reflected and exploited through changes in American foreign aid policy.

Today, we will hear from Mr. William Colby, former Director of the Central Intelligence Agency; Mr. Alton Frye, Vice President and Washington Director of the Council on Foreign Relations; Dr. David A. Hamburg, President of the Carnegie Corporation of New York; Dr. John Steinbruner, Director of the Foreign Policy Studies Program of the Brookings Institute; and Dr. Ted Warner, Senior Defense Analysis for the Rand Corporation. I am used to referring to you as "Ted," and not "Ed."

Let me simply stop at this point unless Mr. Edwards has something to add.

I'm sorry, Mr. Edwards is not here but Mr. Lewis is here.

Jerry.

Mr. LEWIS. I just want to congratulate the Chairman for these kinds of panels. They are very, very helpful.

Off the record.

[Discussion off the record.]

Mr. OBEY. Why don't we start with Mr. Colby and please take whatever time you like. We are not going to be persnickety about time.

MR. COLBY'S OPENING STATEMENT

Mr. COLBY. I will just say a few words to outline a few general points, Mr. Chairman.

We are today at as important a change in the world's history as we were at VE Day—the end of an era of threat and danger, and the job of constructing a new world.

The people who did that in the late 1940s did a magnificent job with the United Nations, the World Bank, the IMF, the Marshall Plan, and a variety of other things.

We today have the chore of constructing a new order, to include those portions of the world who declined to join that brilliant concept at that time. We have as big a job of instructing the future as we did of going through that long, Cold War affair.

During the past years, the World, as a whole, has spent $1 trillion a year on military forces and weapons, with 30 percent of that by the United States, 30 percent by the Soviet Union, and 20 percent by their NATO and Warsaw Pact allies. That is $800 billion a year that has been tied up in the Cold War over these past years.

Now, if the Cold War is declining, then I think your peace dividend is in the neighborhood of $400 billion of that, or half of it. That is a very modest reduction. You cannot arrive at it in one year or two years, but you can arrive at it over the course of this coming decade.

This gives us the tools to do some of the things that we need.

Obviously, there are a lot of appetites, as you, Mr. Chairman, indicated, for that peace dividend. But I think foreign aid should be given a reasonable percentage of it.

The current budget is $15 billion. That is not much when compared to the kind of defense budget we have had.

I have always advocated some way of figuring a trade-off between the cost of an additional carrier and saving a continent by political and economic aid. I think sometimes that kind of assistance can do more than an additional carrier.

I know that is a complicated subject to get through the Committee system of the Congress. But, nonetheless, I think it has to be borne in mind.

Now, what sorts of things should we be thinking of?

POLITICAL DEVELOPMENT IN EMERGING DEMOCRACIES

I think first we should look at the area of political development. This is a process which we have barely begun on with the National Endowment for Democracy. We have a variety of other programs, such as the Fulbright Program and others, the USIA, to carry the word of democracy to the rest of the world.

The present budget of the National Endowment for Democracy is $15 million. This is not "billion," Mr. Chairman, but "million." And yet, it has had a distinct impact on the successful, people-power election of Mr. Aquino in the Philippines, the "NO" campaign in Chile to end the dictatorship there, the recent victory of Mrs. Chamorro in Nicaragua. This has all been assistance. It hasn't all been done by itself. But it has been assistance.

As we look at the need in Western Europe to construct the democratic systems, the democratic institutions, we are going to need exactly that kind of funding for that sort of thing.

NED has given assistance to Solidarity in the past. The victory of Solidarity now presents it the job of running a country and having the democratic institutions to do so. There are elections throughout Eastern Europe this spring, which should be the subject of considerable effort of political development by our country.

ECONOMIC PROGRAMS AND DEBT BURDENS

The second category I would offer you is economic programs. Here I particularly point out Latin America, where the crushing debt of those countries has made the normal citizen of Latin America, as a whole, poorer this year than he was ten years ago.

The per capita income is less than it was ten years ago. That is a decade lost, a regression.

Now that is going to create trouble. It already is creating trouble. Our government came up first with the Baker Plan as a gradual move to try to alleviate that. We now have the Brady Plan which, in ten or 12 months of negotiation, has produced one agreement in Mexico, which will save the Mexican Government about $1 billion, out of the $9 billion that it pays every year.

Now that is a tiny impact on an enormous problem. It is like sending a squad to fight a division. You are not going to get very far with that.

So I say that this is a second area: economic assistance to relieve the debt burden.

Now, I don't mean to just pay off the banks and I don't mean that they shouldn't have some discipline in their internal economic systems. But, nonetheless, the objective should be to relieve that burden. We can figure out how to do it after we accept it as a high priority demand.

This is not just altruism. This is selfish because America has lost jobs which formerly produced products that were sold to Latin America. We have lost 200,000 jobs in our exports to some parts of Latin America.

I think that this is a justification for moving vigorously on this kind of program.

POVERTY ALLEVIATION

The third area is the more traditional one, which is the alleviation of the misery and the agony that creates the extremism, the religious-ethnic fighting and pressures.

This is a problem that we need to help. It does fit in more with traditional aid. But, as you look at our present economic aid program, it is still rather minor compared to our military aid program.

If we are headed toward a world which is more dominated by political and economic considerations, and less and less by strategic and military considerations, then we have to move the emphasis of our foreign aid program away from those five countries that take the bulk of it and squeeze out the others because of our military interests in them and move toward a more rational allocation of our economic assistance.

Again, that's some of that peace dividend—not all of it. But, take a look. If we save $150 billion out of the peace dividend, half of our defense budget over the next ten years, would it not be reasonable to ask for a simple $15 billion more for foreign assistance in these categories?

There is an old military principle that when you break through the lines, you're supposed to send the cavalry and everything else to exploit that opening and go for total victory. That's the blitzkrieg. It's time for an economic, social, and political blitzkrieg because the lines of communism and totalitarianism have been broken.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Colby follows:]

TESTIMONY OF WILLIAM E. COLBY, DIRECTOR OF CENTRAL INTELLIGENCE, 1973-1976

The world as a whole in recent years has spent something over $1 trillion annually on military forces and weapons. About 30 per cent of this was spent by the United States, and another 30 per cent by the Soviet Union. Our NATO and Warsaw Pact allies respectively spent another twenty per cent. In sum, some 800 billion dollars have been devoted to the Cold War.

With the end of the Cold War, thanks to the changes in the Soviet Union and Eastern Europe, a responsible and rational "peace dividend" for the world could consist of 400 billion dollars, and for the United States one half of our military budget—some 150 billion dollars. This may not be immediate, and should not in prudence be, but it is clearly ahead over the next decade.

The claims on this dividend will be many—debt deficit, educational needs, the drug war, and many others. But let us make a clear call for a modest investment in foreign assistance among them. Foreign assistance, properly allocated, can produce direct benefits to the United States, in financial as well as strategic terms.

The President's budget calls for a continuation of our investment in the B-2 bomber, at over $500 million each. But we must consider the possible trade-offs of such expenditures on other objectives:

Doubling the present budget of the National Endowment for Democracy, the United States Information Service and our radio and television programs, and the Fulbright and other scholarship programs, for their activities assisting private groups to enlist local citizens in associations to assert their democratic aspirations in their local political forums and programs to develop personal and direct relationships with the United States.

Economic programs to reduce the crushing burdens of the debt of the Latin American nations, not to relieve these nations of the need to adopt serious economic programs or the banks which imprudently extended financially improvident loans to them, but to stimulate their economic growth and the markets they offer for the products of American enterprises and workers.

Development programs to give hope to the frustrated millions in the Third World nations that a better life lies ahead in cooperating in free economic development with the United States and the free nations of the world, not seeking nostrums of salvation in extremist protest and terrorism.

Foreign assistance is not merely charity—it is self-interest. Well designed and effective programs to produce democratic development and economic growth can produce real and specified returns to the benefit of the American voter and taxpayer, far beyond those he or she could obtain from contributions to greater military force in an era of economic, not military, competition in the years ahead.

Mr. OBEY. Thank you very much.

Mr. Frye.

MR. FRYE'S OPENING STATEMENT

Mr. FRYE. Thank you, Mr. Chairman.

I am very pleased to have this opportunity to explore with the Committee and with a group of colleagues I know and admire very much the way in which the radical transformations in East-West relations should alter the wider agenda of American foreign policy.

It is obviously going to take hard analysis and decisive leadership if we are going to make this passage one of reorientation, rather than disorientation.

The current proposals for foreign assistance are transitional in nature. We have not yet revisited the basic choices that shape such programs.

The administration has struck some initial balances that I think are promising. It plans to commit major resources to bolster the process in Eastern Europe. It proposes more funds for international organizations, whose roles are expected to gain importance in the coming decade. Moreover, Secretary of State Baker and Secretary of Defense Cheney have taken an important step to diminish the perverse leverage some countries have employed in negotiations over American bases. It will be a wholesome trend if future bargaining reflects Mr. Baker's insistence that we stay only where the host country welcomes our presence and acknowledges that the bases are mutually advantageous.

RECALIBRATION OF U.S. SECURITY AND ECONOMIC ASSISTANCE

Beyond these constructive tendencies, the logic of reduced super power rivalry argues for a comprehensive recalibration of U.S. security and economic assistance. The time is at hand, if it ever is going to be, for a zero-based budget review. Old habits are not the same as first principles. We need to redefine the basis on which we erect foreign assistance programs.

Every dollar allocated by the Congress for such purposes should be subject to a series of tests. I would mention only three.

First, was the original rationale for the allocation driven mainly by the Cold War calculus?

Second, does this allocation serve or subvert related foreign policy goals being pursued by the United States?

Third, does the commitment introduce new distortions into foreign policy assistance programs of a long-term nature?

These questions illustrate the criteria we need to apply as we shape new initiatives for a very different international context.

Cold War hostilities have been the cholesterol of foreign policy. They have clogged our brains and hardened our categories. The task now is to devise a balanced policy appropriate to a more benign relationship between the super powers.

The challenge is two-fold: to adapt U.S. assistance to critical needs, shorn of Cold War compulsions, while hedging against a possible reversal of the favorable trends in East-West relations.

The new era cries out for a substantial shift in the relative emphasis on security assistance, as compared with economic assistance. Virtually all of the major security assistance programs have been affected by regional equations of super power interests.

U.S. security assistance over time ought to be declining from current levels. It will be hard to trim foreign military sales and related assistance when U.S. defense cutbacks are dislocating workers and shortening production runs. Yet we need to face these implications directly. There is no valid basis for easing our own distress by maintaining greater military assistance to countries whose first priority should be increased development funding.

FOREIGN AID AND FOREIGN POLICY OBJECTIVES

There is an urgent need to eliminate contradictions between our foreign assistance allocations and larger policy objectives. Where the actions of aid recipients collide with vital American interests, it is absurd not to defend the U.S. stake. Linkage, applied judiciously and with due regard for the interests of others, is an appropriate tool of American diplomacy.

If a recipient is pursuing the nuclear weapons capabilities against which the United States and other parties to the Non-Proliferation Treaty stand united, that fact should bear on the scale and character of U.S. assistance.

Both the United States and the Soviet Union should give increasing weight to anti-proliferation objectives. The same is true regarding the spread of chemical weapons and missile delivery capabilities, both topics on which Soviet-American negotiations are moving forward.

We should impede the fungibility of resources by curtailing assistance that frees a recipient to apply other funds for unacceptable purposes.

While working for a settlement in Afghanistan, the United States should act on its concern regarding nuclear developments in South Asia without excessive deference for Pakistan's role in the Afghan conflict.

Yes, resentments are unavoidable. But on issues of this magnitude, diplomacy must be forthright if it is to be responsible.

Secretary Baker the other day illustrated a similar concept when he spoke of democratic differentiation in assistance for Eastern Europe, making it quite clear that the generosity of American assistance will be contingent on democratic reforms in those countries.

This principle applies with equal force to the Middle East. The fragile peace process struggling to bear fruit poses unique demands on the American political system, no less than on the parties directly involved.

One of the gravest threats to that process is the extension of Israeli settlements in the occupied territories of the West Bank. The United States has condemned such settlements. The fear that the expanded flow of Soviet emigres would encourage further settlements has added new complications. The Soviets have now delayed implementing direct flights to Israel, thus slowing the exodus for many Jews anxious to begin a new life.

Confrontation with a friend is never congenial, but a sharper line now seems necessary. American policy has already required foreign assistance contracts to prohibit certain expenditures on the West Bank. If Israel invests in settlements there, the United States should adjust assistance levels by comparable amounts. A dollar spent on West Bank settlements should mean a dollar less in American assistance.

Increased aid for housing and other assistance for the thousands of Soviet refugees would be laudable, but not if it frees Israel to underwrite provocative settlements in the occupied territories.

The question for U.S. policy must be, "does assistance bolster or weaken the peace process?" We must apply linkage if U.S. policy is to be coherent.

The heirs of the Judeo-Christian heritage should not be subsidizing violations of the Eighth Commandment. Transactions under military occupation are intrinsically coercive.

As Nelson Mandela insisted that prisoners cannot negotiate, we must insist that land transfers in the West Bank today are inevitably tainted.

Dwight Eisenhower faced a similar tough call in 1956, when he preserved the Nation's moral leadership by disassociating the United States from the invasion of Suez. If we cannot persuade Israel to alter its settlements policy, then the United States must distance itself from that policy or lose all credibility as an honest broker for peace.

Unless that posture is reflected in our assistance commitments, it is bound to appear as mere rhetoric.

It is not practical for Congress to make the precise linkage between assistance commitments and the peace process. So a grant of greater discretion to the President is appropriate. It would be wise.

Such authority might usefully permit variations in assistance levels in a range of cases: for example, hostile intelligence operations in the United States; support for organizations or individuals engaged in terrorism or drug traffic; violations of human rights.

ASSISTANCE TO EASTERN EUROPE

A final observation: it is imperative that we assist political and economic reconstruction in Eastern Europe. Unless we help secure the economic foundations of a new social order in that area, the flush of anticipated success could turn into despair and frustration.

Yet there is a clear distinction between the assistance requirements of Eastern Europe and those of the Third World. Unlike truly underdeveloped countries, Eastern Europe's educated population and reasonably well-trained workforce can speed modernization, even after the setbacks of central planning and decades of authoritarianism.

Their situation is more akin to the decimated states benefitted by the Marshall Plan than to countries in the Third World which have never known prosperity.

One would expect the European countries to move rather quickly, beyond heavy reliance on public sector support to effective competition for private investment and trade. Public funding by the United States and other donors should serve mainly to catalyze the movement of those countries to functioning market economies. To be sure, the prognosis will vary from country to country.

There is deep anxiety among the neediest nations that scarce assistance will be diverted to Eastern Europe. No doubt some of that is taking place. But, over the long haul, the relaxation of East-West tensions should work to free greater resources for development assistance in the Third World.

It is important not to allow immediate commitments to Eastern Europe to become perpetual obligations. The grimmer and more onerous task of helping the poorer nations of the South enter the modern world should have increasing call on public sector aid as the decade progresses. The need for bilateral and multilateral programs there will persist well into the next century.

The fading of the constellation of antagonism in Europe, as Helmut Schmidt once called it, allows a more differentiated approach to the Third World. Potentially, one might see a greater division of labor with other donor countries, permitting the United States to increase its focus on the Western Hemisphere. That should not mean an exclusive concern for our near neighbors. But they deserve better than they have received during the years which the United States has just passed through, and when it had for powerful geopolitical reasons to concentrate its heavier contributions in active zones of competition with the Soviets.

No single, simple theme can do justice to the complex choices we must make in refining U.S. assistance programs. Demanding challenges lie ahead. But we should take heart that they are more constructive challenges than many of those which have consumed our energies for more than four decades.

Preserving the peace has been and remains a noble mission. Yet it is only a prerequisite to the nobler task of building a community of nations both free and prosperous. That is the mission to which the United States and its partners are now called.

Thank you very much.

[The prepared statement of Mr. Frye follows:]

TESTIMONY OF ALTON FRYE
Vice President, Council on Foreign Relations
(Testifying in a personal capacity)

Subcommittee on Foreign Operations
Committee on Appropriations
U.S. House of Representatives
February 28, 1990

Mr. Chairman and members of the Subcommittee, I welcome this opportunity to participate in the attempt to find our foreign policy bearings in a period of momentous change. The unfolding transformation of East-West relations, including the peaceful revolutions in Eastern Europe, not only marks a watershed in superpower relations; it should alter the wider agenda of American foreign policy, including fundamental adjustments in North-South relations. On that agenda the role of U.S. foreign assistance programs must hold a prominent place. It will take hard analysis and decisive leadership to make this passage one of reorientation, rather than disorientation.

As in the pending defense budget, we need to accept that the current proposals for foreign assistance are transitional in nature. We have not yet revisited the basic choices that shape such programs. But the debate now beginning ought to lead in that direction. The Administration has struck some initial balances that are significant and promising. It has put forward plans to commit major resources to bolster the process in Eastern Europe. It proposes to begin meeting U.S. arrearages and obligations to international organizations, among them the International Development Association, whose roles are expected to gain importance in the coming decade.

Moreover, Secretary of State Baker and Secretary of Defense Cheney have taken an important step to diminish the perverse leverage some countries have employed in negotiations over American bases. It will be a wholesome trend if future bargaining over bases reflects Mr. Baker's insistence that we stay only where the host country welcomes the American presence and acknowledges that such bases are mutually advantageous, rather than an accommodation to U.S. desires. Too often base rights negotiations have been skewed by our own preoccupations with the need to maintain forward positions against a global adversary and by the local government's sense that it had the United States over a barrel. Those factors have also intruded in decisions on foreign assistance programs affecting such countries. Perhaps such decisions can now be based on more rounded judgments about the requirements and opportunities for economic development in particular settings. Obviously, we need to be careful that shifts in U.S. basing do not trigger regional instabilities, but we should be able to make clearer assessments of those prospects without treating them as a function of decisions made in Moscow.

Beyond the constructive tendencies displayed in the Administration's proposals, the logic of reduced superpower rivalry argues for a comprehensive recalibration of U.S. security and economic assistance programs. No one should assume that Moscow and Washington have put all friction and competition behind them. There will still be jostling for political advantage in various regions. But the evidence now in hand, not least the emergence of forthright consultations with the Soviets on regional disputes, suggests that there are now possibilities for cooperation in dampening regional conflicts, instead of perceiving them as contests for superpower influence.

The time is at hand for a zero-based budget review in this sector. Old habits are not the same as first principles and we need to redefine the basis on which we erect foreign assistance programs. With great respect for the efforts made by many public servants to frame sound policy in this area, I would suggest that every dollar allocated by the Congress for such purposes should be subject to a series of tests.

(1) Was the original rationale for the allocation driven mainly by the Cold War calculus? If so, has the situation changed enough to undermine that rationale?

(2) Does this allocation serve or subvert related foreign policy goals being pursued by the United States? If so, what can be done to make the foreign assistance effort consonant with those other policy objectives?

(3) Does the commitment introduce new distortions into long-term foreign assistance programs? If so, how can it be reconciled with the enduring objectives that should govern our assistance?

These questions are illustrative, not exhaustive, but they are the kind of criteria we need to apply as we shape new initiatives for the different international context now developing.

Cold war hostilities have been the cholesterol of foreign policy. They have clogged our brains and hardened our categories. The task now is to devise a balanced policy that blends assistance programs with other instruments appropriate to a more benign relationship between the superpowers. The challenge is two-fold, to adapt U.S. assistance to critical needs shorn of Cold War compulsions, while hedging against possible reversal of the favorable trends in East-West relations.

The new era cries out for a substantial shift in the relative emphasis on security assistance as compared with economic assistance. Virtually all of the major security assistance programs have been affected by calculations of how recipients fit into regional equations of superpower interests. That is evidently true of all the countries enjoying high earmarks for such assistance.

Admittedly, in the Middle East and South Asia other considerations are weighty, but --- especially if it now proves feasible to elicit parallel restraint in Soviet military aid to states they supply --- U.S. security assistance ought to decline from current levels. One must acknowledge that it will be harder to trim foreign military sales and related assistance when U.S. defense cutbacks are dislocating workers and increasing costs by shortening production runs. Yet we need to face these implications directly. Surely there is no valid basis for easing our own distress in restructuring defense by maintaining greater military assistance to countries whose first priority should be increased development assistance funding.

We should now deal with the urgent need to eliminate contradictions between our foreign assistance allocations and larger policy objectives. Several situations demand more clarity about our priorities than we have provided. In general the United States is wise to respect the sovereign preferences of states with whom we have assistance relationships. However, where those preferences collide with vital American interests, it is absurd not to defend the U.S. stake. To revive an old theme, linkage, applied judiciously and with due regard for the interests of others, is an appropriate tool of American diplomacy.

If a recipient is pursuing the nuclear weapons capabilities against which the United States and other parties to the Non-Proliferation Treaty stand united, that fact should bear on the scale and character of U.S. assistance. Indeed, to the extent that superpower rivalry yields to cooperation in containing the nuclear threat, the assistance programs of both the United States and the Soviet Union should give increasing weight to antiproliferation objectives. The same is true regarding the spread of chemical weapons and missile delivery capabilities, both topics on which Soviet-American negotiations are moving forward.

We should be prepared to impede the fungibility of resources by curtailing assistance that frees a recipient to apply other funds for unacceptable purposes. Why should the United States provide a level of aid that facilitates the diversion of other resources to frustrate major U.S. and international policy objectives? These considerations make it even more urgent to speed a conclusion to the violence in Afghanistan, so that the United States can act on its concern regarding nuclear developments in South Asia without excessive deference for Pakistan's role in the Afghan conflict. Yes, resentments are unavoidable, but on issues of this magnitude diplomacy must be hard if it is to be responsible.

This principle applies with equal force to the Middle East. Needless to say it will require courage and skill to make it work in a setting so volatile and so burdened with the barnacles of history. The fragile peace process struggling to bear fruit poses unique demands on the American political system, no less than on the parties directly involved in the region. It is necessary to state frankly that one of the gravest threats to that process is the extension of Israeli settlements in the occupied territories of the West Bank.

The United States has condemned such settlements. The fear that the expanded flow of Soviet emigres --- a flow which the United States has sought to make possible for more than a decade and for which Israel has yearned --- would encourage further settlements has added new complications. That fear has persuaded the Soviets to delay implementing an arrangement for direct flights to Israel, thus slowing the exodus for many Soviet Jews anxious to begin a new life.

American policy has already addressed this problem by requiring foreign assistance contracts to prohibit certain expenditures on the West Bank. Confrontation with a friend is never congenial, but a firmer and sharper line now seems necessary. If Israel persists in investing in settlements on the West Bank, the United States should make clear that it will adjust assistance levels by comparable amounts. That point gains added force in evaluating the possibility of increased aid to help provide housing and other assistance for the thousands of Soviet refugees making their way to Israel. Congressional willingness to consider such assistance is laudable, but not if the effect is to free Israel to underwrite provocative settlements and operations in the occupied territories. The question for U.S. policy must be: Does assistance at the level proposed bolster or weaken the peace process on which future stability and development must rest? As difficult as it will be, this is a case where we must apply linkage if U.S. policy is to be coherent.

The heirs of the Judeo-Christian heritage should not be subsidizing violations of the Eighth Commandment. Transactions under military occupation are intrinsically coercive. As Nelson Mandela insisted that prisoners cannot negotiate, we must insist that land transfers in the West Bank today are inevitably tainted.

Dwight Eisenhower faced a similar tough call in 1956 when he preserved the nation's moral leadership in world affairs by disassociating the United States from the invasion of Suez by Britain, France and Israel. Unlike Eisenhower, we do not have to make the decision in a matter of hours. If we cannot persuade Israel to alter its settlements policy, then the United States must distance itself from that policy or lose all credibility as an honest broker for peace. Unless that posture is reflected in our assistance commitments, it is bound to appear as mere rhetoric to others engaged in the peace process.

Synchronizing assistance levels with other U.S. policy goals is a concept distinct from the possibility raised recently by Senator Dole to reallocate 5% or so of the funds earmarked for the 5 major recipients. Secretary Baker's plea to end all earmarking may not be politically acceptable, but the Administration surely deserves greater flexibility to apply assistance dollars where they best serve American interests. It is not practical for Congress to make the precise linkage between Middle East assistance commitments and the peace process, so a grant of greater discretion to the President would be wise. Such authority might usefully permit variations in assistance levels in a range of cases, for example, hostile intelligence operations in the United States, support for organizations or individuals engaged in terrorism or drug traffic, violations of human rights. As a general condition for U.S. assistance, it is appropriate for Congress to require the Administration to certify that foreign governments are not undercutting critical U.S. policies and to allow the President to reduce assistance flows where the recipient thwarts essential American purposes.

My final observation is cautionary. It is imperative that U.S. assistance contribute to the political and economic reconstruction now beginning in Eastern Europe. Unless we help make secure the economic foundations of a new social order in that area, we could confront unmanageable instabilities. The flush of anticipated success could turn into despair and frustration. Yet it is also important to maintain a clear distinction in our minds between the assistance requirements of Eastern Europe and those of the third world. Unlike truly underdeveloped countries, the nations of Eastern Europe possess tremendous advantages. Their educated population and reasonably well-trained work force reinforce economic traditions than can be conducive to modernization even after the setbacks of central planning and decades of authoritarianism. Their situation is more akin to the decimated states which benefitted from the

Marshall Plan than to countries in the third world which have never known prosperity.

Thus assistance to Eastern Europe presents a set of issues different from that in other regions. Broadly speaking, one would expect to see the European countries move rather quickly beyond heavy reliance on public sector support to effective competition for and use of private investment and trade. In that sense public funding efforts by the United States and other donors should serve mainly to catalyze and expedite the movement of those countries to functioning market economies. To be sure the prognosis will vary from country to country. Farther to the east, the outlook is especially cloudy in the Soviet Union itself, though not as hopeless as some contend.

There is, of course, deep anxiety among the neediest nations that assistance will be diverted to Eastern Europe in ways that deplete the pool of resources available for the third world. No doubt some of that is taking place. But over the long haul the relaxation of East-West tensions should work to free greater resources for development assistance in the third world. It is important not to allow immediate commitments to the urgent needs of Eastern Europe to become locked in as perpetual public sector obligations. The grimmer and more onerous task of helping the poorer nations of the south enter the modern world should have increasing call on public sector aid as the decade progresses. The need for bilateral and multilateral programs there will persist well into the next century, indeed as far ahead as one can see. Somehow, over the next few years, we must find a way to strike a balance between the immediate strategic necessity to concentrate significant assistance in Eastern Europe and the chronic strategic requirement to improve the flow of such aid across the north-south divide.

The fading of the "constellation of antagonism" in Europe, as Helmut Schmidt once called it, should allow the developed countries to make a fresh start on differentiating their approach to the countries and regions of the third world. Potentially, one might see a greater division of labor with other donor countries, permitting the United States to increase its focus on the plight of our neighbors in the Western Hemisphere. That should not mean an exclusive concern for our near neighbors, but they deserve better than they have received during the years when the United States, for powerful geopolitical reasons, directed heavier contributions to the most active zones of competition with the Soviets.

No single, simple theme can do justice to the complex choices we must make in refining U.S. assistance programs. Demanding challenges lie ahead, but we should take heart that they are more constructive challenges than many of those which consumed our energies and resources for more than four decades. Preserving the peace has been and remains a noble mission. Yet it is only a prerequisite to the nobler task of building a community of nations both free and prosperous. That is the mission to which the United States and its partners are now called.

Mr. OBEY. Thank you very much.
Dr. Warner.

DR. WARNER'S OPENING STATEMENT

Dr. WARNER. Thank you, Mr. Chairman.

The task that I have been assigned is one of looking at the recent and ongoing changes in the military relationship between East and West, something that must be considered by everyone who seeks to analyze the new, emerging agenda in American foreign policy.

I am pleased to have the opportunity to appear before you this morning to discuss these matters, and I would like to focus my discussion on the NATO-Warsaw Pact conventional balance and the balance between the Soviet Union and the United States in strategic nuclear forces.

NATO-WARSAW PACT CONVENTIONAL BALANCE

Turning first to the question of the Warsaw Pact's military challenge to NATO, a series of events over the past year or so has produced a drastic reduction in the Pact's military potential, to put it rather mildly. Mikhail Gorbachev began this process in December of 1988, when he announced a series of unilateral cuts in Soviet troop strength and selected armaments that are to be completed by the end of this year.

These cuts, which appear to be on schedule and at the halfway point or so, will reduce overall troop strength in the Soviet Union by about 500,000 men—that is, from 5 million to 4.5 million troops. They will also eliminate 10,000 tanks, 8,500 artillery pieces, and 830 combat aircraft from Soviet holdings in Eastern Europe and the European U.S.S.R. Finally, they will trim, in a focused manner, 50,000 troops, 5,300 tanks, as well as six tank divisions and other specialized units from Soviet forces deployed in Eastern Europe.

When we first heard about these events just a little more than a year ago, they seemed rather momentous. The fact of the matter is they have been largely overtaken by other developments over the past several months, particularly since the fall.

Last winter, the Eastern Europeans, prior to the political upheavals in Eastern Europe, announced that they, too, would engage in a substantial unilateral troop reduction. Overall, the Pact's planned elimination in this two year period of some 8,000 of 16,000 tanks due to the unilateral cuts alone would greatly reduce its concentrated armored striking power in the center of Europe. Moreover, depending on how the Soviets were to adjust the artillery strength of the 24 divisions that were to remain in Europe, the aggregate potential of these forces, too, was to be cut by somewhere between 10 percent and 20 percent.

As a result of the unilateral cuts alone, the Pact was going to no longer be in a position to be able to mount a successful short-warning attack, that is, an attack with mobilization preparations of a week or less.

Taking into account only the impact of these unilateral troop cuts, under a long mobilization scenario, that is, one in which the Soviets and their Pact allies would mobilize the reserves, conduct refresher training, and have to move their troops forward into battle positions over a period of many weeks, the Warsaw Pact would, in theory, have maintained a considerable amount of the substantial edge that they have enjoyed for many years. These reductions were slated to reduce that edge by perhaps 33 percent to 40 percent, but the Soviet-Warsaw Pact advantage was to remain.

However, the Pact's residual superiority would rest to a very considerable extent on the presumed contribution that could be made by the Polish, East German, and Czechoslovak armies to a Warsaw Pact military operation, particularly an offensive.

As Table 1 that I have provided in my statement indicates, the East European national armies constitute today over half the Pact's 59 divisions deployed on a day to day basis in Central Europe. They also would make up a third of the 96 divisions that the Pact could bring, in theory, to bear in a long mobilization scenario.

TABLE 1.—WARSAW PACT DIVISIONS FACING CENTRAL EUROPE

	1990	1991	1995 (CFE)[1]
Deployments in Eastern Europe:			
U.S.S.R.	[2] 27	[3] 24	[3] 10
Poland	10	9	5
GDR	6	6	3
Czechoslovakia	10	7	5
Hungary	6	5	3
Subtotal	32	27	16
Total	59	51	26
Reinforcements from western U.S.S.R.	37	37	20–25
Total Warsaw Pact divisions facing Central Europe	96	88	46–51

[1] Assuming an agreement to reduce conventional forces in Europe.

[2] Seventeen Soviet divisions are stationed in the GDR, five in Czechoslovakia, three in Hungary, and two in Poland.

[3] These figures reflect only the implementation of the Gorbachev inspired unilateral cuts and then, by 1995, the implementation of a CFE agreement. They do not factor in the anticipated withdrawals of all Soviet forces from Czechoslovakia and Hungary that are to be completed by the end of 1991, or the likely withdrawal of Soviet forces from East Germany in the wake of German reunification.

Following the collapse of the communist governments throughout Eastern Europe last fall, by far the most significant transformation of the security situation in Europe during 1989, or, for that matter, during the past four decades, Soviet political and military leaders can no longer make the critical presumption of the availability of Eastern European forces to participate in any Soviet-led military campaign. The Pact has become an "empty shell" with respect to its ability to support any large-scale military operations. Nevertheless, the Soviets apparently believe that they can still get some utility out of the Warsaw Pact. At a minimum, as they look into the 1990s, they anticipate that it can provide a security buffer zone vis-a-vis NATO and, more importantly I believe in their calculus, a unified Germany. In addition, the Soviets apparently hope to use a more politically oriented Warsaw Pact to help manage the process of fundamental political and military change that is occurring in Central Europe.

Equally important, the revolution of 1989 has set into motion a train of events that is becoming clearer virtually by the day which appears destined to compel the Soviets to withdraw virtually all of their forces from Eastern Europe over the next few years. Just yesterday, we heard the announcement from Moscow that the Czechoslovak Government has concluded an agreement with the Soviets for the complete withdrawal of all Soviet troops, that is, five divisions and some air units, from its territory by the middle of 1991. The Hungarian Government is engaged in similar negotiations, and appears likely to conclude an agreement soon calling for the removal of all Soviet troops from Hungary by the end of 1991.

More importantly, it would appear that all 17 Soviet divisions currently deployed in the German Democratic Republic will almost certainly have to withdraw within a few years after the anticipated reunification of Germany, which appears likely in the next year or so. Finally, Polish leaders, some seriously concerned about possible German desires to revise the Western Polish frontier, have expressed conflicting views on the wisdom of removing the two Soviet divisions and air units based in their country.

All in all, we are looking toward the recession of Soviet military presence from its forward deployed positions in Eastern Europe toward a point of virtually complete withdrawal back behind the Soviet frontier by the middle of this decade.

CONVENTIONAL FORCES NEGOTIATIONS

1989 also produced remarkable breakthrough in NATO-Warsaw Pact talks on reducing conventional forces in Europe, the so-called CFE negotiations. These negotiations, being held in Vienna, appear likely to produce a NATO-Warsaw Pact agreement by the end of this year. The sides have agreed in principle to reduce selected armaments to common ceilings approximately 10 percent below NATO's current level, thus eliminating the Warsaw Pact's pronounced existing superiority.

In light of the comments I just made about the availability and political disposition of the Eastern European armies, the impact on those armies obviously is far less important to us than the impact on the Soviets themselves. But, because the Soviets tend to deploy at least two-thirds of all of these selected armaments—tanks, artillery, armored troop carriers, armed helicopters and combat aircraft getting reductions down to these common ceilings will have a very drastic effect on the size and character of the Soviet armed forces.

If completed in the form I have just described, the CFE agreement, which would be implemented by the mid-1990s, will result in massive cuts in the Pact's, and most importantly, the Soviet's ground and air forces deployed in the Atlantic-to-the Urals region. This agreement, in contrast to the earlier discussions under the Mutual and Balanced Force Reduction Talks that were carried on fruitlessly in Vienna for some 14 years, we are including not only the forces in the center of Europe, but in all of Europe, back to the Ural Mountains. So this covers all of the European U.S.S.R.

This will bring the two alliances down to a state of approximately parity in ground force capabilities with both sides having roughly 40 divisions total available for a war in Central Europe after a long mobilization scenario, and, again, within those totals, one would be talking about substantial contributions by the Eastern European states. The Pact will likely be required to eliminate several tens of thousands of tanks, artillery pieces, and armored infantry fighting vehicles, as well as several thousand aircraft, while in all of these categories the NATO nations will cut only a thousand or two.

The CFE agreement will also require the Soviets to reduce their troops stationed in Eastern Europe from 565,000 to 195,000, in exchange for an American commitment to reduce its stationed forces from the 300,000-plus today down to 225,000, 195,000 of which can be deployed in Central Europe.

Interestingly, of course, in light of my earlier remarks, the 195,000 is unlikely to prove a reliable floor on Soviet troop presence in Europe. That is, as I noted earlier, I believe they are more likely to remove all of their forces from Eastern Europe by the mid 1990s, than to maintain the 195,000 that they will be authorized under CFE.

The prospective CFE agreement will eliminate the Pact's long-held superiority over NATO. It will probably require the reduction of Soviet troops in Eastern Europe from the current 27 to roughly ten divisions—or the 24 that would have come after the unilateral cuts. Again, those ten divisions are unlikely to stay. It will also compel cuts on Soviet forces based in the U.S.S.R.

Ironically, the deep reductions that now appear achievable under CFE, which were virtually unimaginable to most of us if we had spoken about these matters just a year ago, may well be too small to satisfy the new political realities in Europe today. The recently installed governments that are operating in openly competitive democratic settings in Poland, Hungary, Czechoslovakia, and East Germany have already announced substantial cutbacks in their own armed forces. Moreover, as I have noted several times, these nations will almost certainly compel the withdrawal of most, if not all, Soviet troops from Eastern Europe in the next few years.

SOVIET-UNITED STATES STRATEGIC FORCES

Let me turn now for a few moments and talk about the Soviet-United States central strategic balance and the evolution of Soviet strategic nuclear forces. In this area, the Soviets to date, as Bush administration spokesmen rightly point out, have announced no unilateral cuts. But they have, in fact, negotiated very seriously in Geneva toward conclusion of an agreement to reduce strategic nuclear forces under START. And it appears the pace and character of their ongoing modernization program is geared toward the anticipated conclusion and implementation of a START agreement.

Nevertheless, the modernization of Soviet strategic attack forces continues at a very substantial pace. This effort includes the deployment of three new ICBMs, both in silos and mobile; two new nuclear powered strategic submarines, carrying multiple warhead missiles; and two new heavy bombers that carry a combination of air-launched cruise missiles, short-range attack missiles, and gravity bombs.

Of course, the United States is also embarked on a series of controversial strategic modernization programs. These include two ICBM efforts—a rail garrison deployment of the MX that is currently deployed in silos, and the production and deployment of the new, small, road-mobile Midgetman; production of additional Trident submarines armed with the more accurate D–5 submarine-launched ballistic missile; deployment of the advanced cruise missile, to be put on our heavy bombers (at least initially the B–52s); and, finally, the fielding of the advanced technology B-2 bomber.

In the area of strategic defenses, the Soviets are also proceeding at a substantial pace. They continue to improve their very large air defense network, in particular, beginning to field large numbers of modern, look-down/shoot-down fighter-interceptors supported by the IL–76 Mainstay AWACS and additional SA–10 surface–to–air missiles that, at long last, appear capable of closing the low level window of penetration opportunity that has been available potentially to American bombers for the last several decades. The Soviets are also completing the modernization of their one ABM system around Moscow. They are doing so, incidentally, within the terms of the ABM Treaty of 1972.

The United States' efforts in the area of air defense are largely confined to improvements in our radar networks and, finally, continuing deployments of an air defense version of the F–16 fighter-interceptor. In the area of ballistic missile defense, we have no active ABM sites, and we are continuing, of course, with research in the context of the SDI program on a variety of ballistic missile defense approaches. By all indications, the Soviets also have research activity in several advanced technologies for ballistic missile defense.

START AGREEMENT

President Bush and Mr. Gorbachev agreed at Malta to accelerate the efforts of the two countries to conclude a START agreement during this year. The recently completed Ministerial in Moscow made very important progress in this regard, and it does, in fact, appear that the two sides will conclude such a treaty, I believe, by sometime this fall.

Under the terms of this treaty, each side would be allowed to deploy 6,000 accountable weapons, 4,900 ballistic missile reentry vehicles, and 1,600 strategic delivery vehicles. Moreover, the Soviets would be compelled to reduce their heavy ballistic missile force by half and to reduce their ballistic missile throw-weight by half as well.

We are about to hear, I believe, if such an agreement is signed, a ratification debate, in the United States next fall and winter about the utility of this agreement.

This agreement would produce, for the first time, real reductions in the strategic nuclear arsenals of the two superpowers. The reductions are not as great as the 6,000 number would lead you to believe because there are counting rules with regard to bomber weapons that allow one to deploy more actual than accountable weapons.

Nevertheless, taking a reasonable projection of Soviet forces that might well be deployed under such an agreement, it appears that the Soviet central strategic arsenal would be reduced by roughly 40 percent, that is, from its current level of 11,000-plus actual weapons to a force of around 7,000 weapons by the time the treaty were fully implemented after a seven-year period. The American arsenal would likely contract from approximately 13,000 weapons to 8,000 to 9,000 weapons, depending on the fate of the B-2 bomber. (See Table 2.)

TABLE 2.—UNITED STATES-SOVIET STRATEGIC NUCLEAR BALANCE

	United States	U.S.S.R.
1990		
ICBM's:		
Silo-based/RV's	1,000/2,450	1,218/6,180
Mobile/RV's		188/350
Total, ICBM's/RV's	1,000/2,450	1,406/6,630
SSBN's/SLBM's/RV's	33/592/5,152	62/944/3,676
Heavy bombers/weapons	360/5,504	175/1,240
Total delivery systems/weapons	1,952/13,106	2,525/11,546
START/1998		
ICBM's:		
Silo-based/RV's	314/942	194/1,940
Mobile/RV's	50 or 500/500	542/992
Total, ICBM's/RV's	364 or 814/1,442	736/2,932
SSBN's/SLBM's/RV's	18/432/3,456	18/312/1,968
Heavy bombers/weapons	263/4,115	150/2,000
Total delivery systems/weapons	1,059 or 1,509/9,013	1,223/6,900

The ballistic missile RVs, that is, the fast-flying components on land-based and submarine-launched ballistic missiles, will, in fact, be cut as advertised, at least on the Soviet side, by some 50 percent. They will come down from 10,000 or so to the ceiling of 4,900, while the American side will come down from around 8,000 to 4,900.

In my judgment, the START agreement will represent a very substantial accomplishment in service of the objective of reducing the strategic attack potential of the two sides and enhancing strategic stability between them. It will also have very favorable impacts on arms race and political stability between the two countries.

Nevertheless, even in the presence of a START agreement, the survivability and lethality of Soviet strategic attack systems will undoubtedly improve over the next several years, thanks to continuing deployments within the terms of the treaty of increasingly accurate ICBM's in mobile and silo-based configurations, of quieter submarines carrying more accurate missiles, and of a new penetrating bomber. U.S. strategic forces will also be improved under START, though the degree of that improvement will rest in the hands of the Congress on a series of critical strategic modernization programs.

Despite the continued vigor of these efforts, neither the Soviets nor the United States, however, will have any prospect whatsoever of acquiring the capability to win a nuclear war against its rival. Both Soviet and American political and military leaders are fully aware that each superpower will continue to be able to inflict devastating retaliatory damage against the other, with literally thousands of surviving nuclear weapons, even after absorbing a would-be first strike.

Senior Soviet leaders are pressing for the conclusion of a START I agreement and looking beyond it toward further reductions, as is the American administration, that will reduce American and Soviet nuclear forces, while preserving first strike stability and the overall parity that exists between the two sides.

IMPACT OF EVENTS IN EUROPE

In conclusion, let me summarize the importance of some of these events, particularly the events of the past year and their impacts in Europe.

The Soviets and their allies have begun to decrease unilaterally the size and offensive capability of their military forces due to the Gorbachev unilateral cuts. Much more significantly, Eastern European states are regaining national independence from Moscow.

Clearly, the Soviets can no longer expect these nations to contribute forces to a Soviet-led military campaign. Moreover, Soviet troops are being quietly, but inexorably, pushed out of Eastern Europe. Even greater reductions in the forces of the Soviet Union, in particular, and their Pact allies are likely to come as the result of a CFE agreement. And, in the area of strategic nuclear forces, reductions of both Soviet and American arsenals appear to be in the offing due to the conclusion of a START agreement.

Despite the marked reduction of the Warsaw Pact threat, the United States must work, in my view, to adapt and preserve the NATO alliance and to continue to deploy some American forces in Europe, albeit at much lower levels. This will help to maintain stability at a time of massive political change, and that change is by no means complete at this moment, and to sustain an active American voice in European affairs that are vital to our security.

At the same time, in my view, the West should intensify its efforts to make sure that it does, in fact, conclude both the START and CFE agreements that would significantly reduce the forces on both sides over the next few years.

This is particularly important because of the inherently uncertain political situation in the Soviet Union today. Mr. Gorbachev is caught in a political-economic, almost natural, maelstrom of events, some of which are of his own making. It is very important, in my view, for the United States and its allies to lock in agreements that would reduce Soviet military power very substantially over the next few years because we cannot be sure that Gorbachev will survive tomorrow, next week, or next year. But any successor regime would have great difficulty reversing international agreements, rather than unilateral commitments to restructure their forces alone.

The United States should, of course, also proceed to restructure, prudently modernize, and reduce its own both general purpose and nuclear forces, as such agreements are implemented. Even if the democratic revolutions in Europe are sustained and if we succeed in achieving ambitious arms reductions, the Soviet Union will, of course, nevertheless maintain substantial military power of both a conventional and nuclear variety. Therefore, the United States and its allies will need to adjust their collective forces and military strategy appropriately to insure the maintenance of successful deterrence and defense in the new security environment.

Thank you.

[The prepared statement of Dr. Warner follows:]

STATEMENT OF EDWARD L. WARNER III[1]
HOUSE APPROPRIATIONS COMMITTEE

February 28, 1990

Mr. Chairman:

I am very pleased to have the opportunity to appear before you this morning to address the changing character of East-West relations, with particular emphasis on the national security dimension of this relationship. In response to your request, I should like in my opening remarks to focus on important changes in the military challenges posed to the West by the Soviet Union and its allies in the Warsaw Pact.

THE CHALLENGE IN EUROPE

Turning, first, to the question of the Warsaw Pact's military challenge to NATO, a series of events over the past year or so has produced a drastic reduction in the Pact's military potential. Mikhail Gorbachev began this process in December 1988 when he announced a series of unilateral cuts in Soviet troop strength and selected armaments that are to be completed by the end of 1990.

These cuts, which appear to be on schedule at this point, will reduce overall Soviet troop strength by 500,000 men, that is, from 5.0 to 4.5 million men. They will also eliminate 10,000 tanks, 8500 artillery pieces, and 830 combat aircraft from Soviet holdings in Eastern Europe and the European USSR. Finally, they will trim 50,000 troops, 5300 tanks, and 6 tank divisions from Soviet forces deployed in Eastern Europe and result in the withdrawal of specialized air-assault and river-crossing units from the forward area.

Last winter, prior to the recent political upheavals, the East European members of the Warsaw Pact announced parallel reductions in their forces. The Poles, Hungarians, East Germans, Czechoslovaks, and Bulgarians declared their intention to eliminate a collective total of 5 divisions, 2750 tanks, 1530 artillery pieces, 895 armored personnel carriers, and 210 combat aircraft by the end of 1990.

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[1] Edward L. Warner III is a senior defense analyst at The RAND Corporation. The views and conclusions expressed are those of the author and should not be interpreted as representing those of The RAND Corporation or any of the agencies sponsoring its research.

The Soviets also announced that they are restructuring the ground force units that will remain after the unilateral reductions are completed. These restructured Soviet ground forces are proving to be balanced, versatile combined-arms formations. They are well suited to employ infantry operating with tanks and concentrated artillery support in a manner that is equally capable of supporting maneuver-oriented offensive or defensive operations.

The Pact's elimination of nearly 8000 tanks due to these unilateral cuts will greatly reduce its concentrated armor striking power in Central Europe. Moreover, depending upon how the Soviets adjust the artillery strength of the 24 divisions that had been slated to remain in Europe, the aggregate combat potential of these forces upon completion of these unilateral cuts--measured according to the Division Equivalent Force methodology--will, in my view, be between 10 and 20 percent lower than that of the Soviet force that was in place when the reductions were announced in December 1988.

As a result of these Soviet and East European unilateral cuts alone, without taking into account the effects of the recent democratic revolutions in Eastern Europe, a Pact attack on NATO in Central Europe following short mobilization preparations of a week or less would entail very serious risks for the Pact. Consequently, such an attack, which has never been very plausible, will no longer be a viable Pact military option.

Under a long-mobilization scenario, that is, one in which both sides were able to mobilize reserves, conduct refresher training, and move their forces forward over a period of many weeks prior to the outbreak of war, the Warsaw Pact would, in theory, retain a substantial portion of its very considerable long-standing advantage. In this case, the Pact could bring to bear some 96 divisions within 5 to 6 weeks after mobilization began while NATO could muster only 45 or so. The unilateral cuts announced last winter alone were going to be sufficient to reduce the Pact's margin of advantage over NATO by some 33 to 40 percent.

However, the Pact's residual superiority over NATO would rest in large part on the presumed contributions of the Polish, East German, and Czechoslovak armies to a Soviet-led campaign. Following the collapse of the communist governments throughout Eastern Europe last fall--by far the most significant transformation of the security situation in Europe during 1989 or, for that matter, during the past four decades--Soviet political and military leaders can no longer make this critical presumption.

As Table 1 indicates, the East European national armies constitute today over half of the Pact's divisions deployed on a day-to-day basis in Central Europe. They also make up approximately 33 percent of the divisions that the Pact could, in theory, bring to bear in a long-mobilization scenario.

Observers in the West have speculated for many years about the likely reliability of East European forces, that is, their willingness to fight NATO forces on the battlefield, should NATO-Warsaw Pact combat occur. Following the dramatic collapse of communism throughout Eastern Europe, the Soviets must assume that the democratic governments of their erstwhile allies will be unwilling to make their forces available to the Soviet High Command under almost any conditions.

Today the Soviets cannot rely on the Warsaw Pact as an effective instrument to marshal East European participation in support of military operations directed against NATO. The Pact has become an "empty shell" with respect to its ability to support a large-scale offensive campaign. Nevertheless, the Soviets believe that the Warsaw Pact can still serve their interests. At a minimum, they anticipate that it can provide a security buffer zone vis-a-vis a unified Germany and NATO. In addition, the Soviets apparently hope to use a more politically oriented Pact to help manage the process of political and military change in Central Europe.

Table 1

WARSAW PACT DIVISIONS FACING CENTRAL EUROPE

	1990	1991	1995 (CFE)[a]
Deployments in Eastern Europe			
USSR	27[b]	24[c]	10[c]
Poland	(10)	(9)	(5)
GDR	(6)	(6)	(3)
Czechoslovakia	(10)	(7)	(5)
Hungary	(6)	(5)	(3)
Subtotal	32	27	16
Total	59	51	26
Reinforcements from western USSR	37	37	20-25
Total Warsaw Pact divisions facing Central Europe	96	88	46-51

[a] Assuming an agreement to reduce conventional forces in Europe.

[b] Seventeen Soviet divisions are stationed in the GDR, five in Czechoslovakia, three in Hungary, and two in Poland.

[c] These figures reflect only the implementation of the Gorbachev inspired unilateral cuts and then, by 1995, the implementation of a CFE agreement. They do not factor in the anticipated withdrawals of all Soviet forces from Czechoslovakia and Hungary that are to be completed by the end of 1991, or the likely withdrawal of Soviet forces from East Germany in the wake of German reunification.

Equally important, the revolution of 1989 has set in motion a train of events that appears destined to compel the Soviets to withdraw virtually all of their forces from Eastern Europe over the next few years. The Czechoslovak government has already concluded an agreement with Moscow for the complete withdrawal of Soviet troops from its territory by the middle of 1991. The Hungarian government appears likely to secure an agreement for the removal of all Soviet troops from its soil by the end of 1991. All 17 Soviet divisions currently deployed in the GDR will almost certainly have to be withdrawn within a few years after the anticipated unification of Germany, which appears likely in the next year or so. Finally, Polish leaders, some seriously concerned about possible German desires to revise the Polish western border, have expressed conflicting views on the wisdom of removing the two Soviet divisions and various air units based in their country.

1989 also produced a remarkable breakthrough in the NATO-Warsaw Pact talks on reducing conventional forces in Europe (CFE). The CFE negotiations being held in Vienna appear likely to produce a NATO-Warsaw Pact agreement by the end of this year. The sides have agreed in principle to reduce selected armaments--tanks, artillery, armored infantry vehicles, combat aircraft, and armed helicopters--to common ceilings approximately 10 percent below NATO's current levels, thus eliminating the Warsaw Pact's pronounced existing superiority.

If completed in this form, the CFE agreement, which will be implemented by the mid-1990s, will result in massive cuts in the Pact's ground and possibly air forces based in the "Atlantic to the Urals" region. This will bring the two alliances down to a state of approximate parity in ground forces capabilities with both sides having roughly 40 divisions available for war in Central Europe under a long-mobilization scenario. The Pact will be required to eliminate several tens of thousands of tanks, artillery pieces, and armored infantry vehicles, while NATO will cut only a few thousand of these weapons. The less clear pattern of air reductions likely to emerge from the Vienna talks could involve the elimination of many thousands of Warsaw Pact combat aircraft, while NATO would likely reduce no more than a thousand. The CFE agreement will also require the Soviets to reduce their troops stationed in Eastern Europe from 565,000 to no more than 195,000 in exchange for a reduction in U.S. forces stationed in Western Europe of roughly 80,000 troops down to a 225,000 ceiling.

The prospective CFE agreement will eliminate the Pact's long-held superiority over NATO. It will probably require the reduction of Soviet forces in Eastern Europe from 24 to, roughly, 10 divisions. At the same time, the Soviets are likely to cut back their divisions in the western military districts of the USSR from 37 to perhaps 20 to 25 and probably reconfigure many of them into "machine-gun artillery divisions," to be used to man "fortified regions" along the Soviet border. The CFE agreement will also require the Eastern European states to drastically reduce their forces.

This agreement, combined with accelerating Soviet troop withdrawals from Central Europe, should greatly reduce the potential for a successful Pact theater offensive to the depth of NATO territory under any condition of mobilization and war initiation. This conclusion is based on two assumptions: first, that NATO's forces are maintained at or near the authorized ceilings and at sufficient levels of readiness and, second, that the Pact attack be carried out with forces drawn from Eastern Europe and the European USSR. The Pact could regain substantial offensive capability were it able to quickly add 15 or more divisions from Soviet forces stationed east of the Urals. However, recently begun force reduction negotiations between the Soviet Union and China may significantly cut Soviet forces in Asia and thus limit the divisions that could be made available for use against NATO.

Ironically, the deep reductions that now appear achievable under CFE may well be too small to satisfy the new political realities in Eastern Europe. The recently installed governments operating in openly competitive democratic settings in Poland, Hungary, Czechoslovakia, and East Germany have already announced substantial cutbacks in their own armed forces. Moreover, their demands on Moscow, noted earlier, will almost certainly compel the withdrawal of most, if not all, Soviet troops from Eastern Europe within the next few years.

THE STRATEGIC NUCLEAR BALANCE

Changes in Soviet strategic nuclear forces and in the U.S.-Soviet strategic balance have been much less dramatic. Moscow has announced no unilateral cuts in its central strategic forces, although the pace and scope of its ongoing modernization effort appears geared to the expected conclusion of a START agreement.

Nevertheless, the modernization of Soviet strategic attack forces continues at a substantial pace. This effort includes the deployment of three new ICBMs (SS-18 Mod 5, SS-24, SS-25) in silos and on mobile launchers; two new SSBNs (Typhoon and Delta IV) carrying MIRVed SLBMs (SS-N-20 and SS-N-23); and two new heavy bombers (Bear H and Blackjack) carrying air-launched cruise missiles (AS-15 and AS-X-19), short-range attack missiles (AS-16), and gravity bombs. The United States is also embarked upon a series of strategic modernization programs, including two mobile ICBMs (MX rail garrison and the road mobile Midgetman), additional Trident SSBNs equipped with D-5 MIRVed SLBMs, the advanced cruise missile, and the B-2 bomber.

The Soviets are also upgrading their strategic defenses. They are examining and improving their vast radar tracking network and will almost certainly continue to deploy large numbers of Su-27 Flanker and MiG-31 Foxhound "look-down, shoot-down" fighters, supported by the Il-76 Mainstay AWACS, as well as additional SA-10 surface-to-air missiles. These deployments will provide the substantial and long-sought intercept capabilities against aircraft and cruise missiles designed to penetrate Soviet airspace at low altitude. U.S. air defense efforts are largely confined to continuing radar upgrades with the deployment of over-the-horizon backscatter radars and the improved North Warning System, as well as an air defense variant of the F-16 fighter-interceptor.

The Soviets are just completing the modernization of the limited ABM system around Moscow--modernization that has been carried out within the terms of the ABM Treaty of 1972. Over the past several years, they have added the large phased-array Pillbox battle management radar, as well as two new silo-based interceptor missiles. The U.S. has no active ABM system. Both the Soviet Union and the United States are pursuing research in advanced ballistic missile defense systems and in countermeasures to combat such systems.

President Bush and Mr. Gorbachev agreed at the Malta summit to accelerate efforts to conclude a START treaty in 1990. The sides appear likely within the year to sign an agreement allowing each to deploy [illegible] accountable weapons, 4900 ballistic missile RVs, and 1600 delivery vehicles, limiting the Soviet Union to no more than 154 "heavy" ICBMs, and halving Soviet ballistic missile throwweight.

The implementation of such an agreement will likely reduce the Soviet central strategic arsenal roughly 40 percent, that is, from its current level of approximately 11,500 weapons to a force with roughly 7000 weapons. The U.S. arsenal of central strategic weapons will likely contract from 13,300 to approximately 9000 weapons due to START. The larger U.S. force anticipated reflects a more effective exploitation of the generous counting rules for air-launched cruise missiles and non-ALCM heavy bombers. (See Table 2.) Ballistic missile RVs, the fast-flying component of the superpowers' strategic arsenals, will be reduced by over 50 percent for the Soviets, that is, from 10,300 to 4900 while the U.S. will reduce its ICBM and SLBM RVs from 7800 to 4900, that is, by 37 percent.

Even in the presence of a START agreement, the survivability and lethality of Soviet strategic attack systems will undoubtedly improve over the next several years thanks to continuing deployments of increasingly accurate ICBMs in both mobile and silo-based configurations, quieter SSBNs carrying more accurate SLBMs, and a new penetrating bomber. U.S. strategic forces will also be improved under START. Despite the continued vigor of these efforts, neither the Soviet Union nor the United States will have any prospect whatsoever of acquiring the capability to "win" a nuclear war against the rival superpower.

Soviet political and military leaders, like their American counterparts, are fully aware that each superpower will continue to be able to inflict devastating retaliatory damage against the other with thousands of surviving nuclear weapons, even after absorbing a would-be disarming first strike. Over the past several years, the Soviets have come to adopt Western terminology and to describe the existing retaliatory deterrent stalemate between the Soviet Union and the United States as a situation of "mutual deterrence" and "strategic stability." Senior Soviet political and military leaders are pressing for the conclusion of strategic arms reduction agreements in START I and beyond

Table 2

U.S.-SOVIET STRATEGIC NUCLEAR BALANCE

	US	USSR
1990		
ICBMs		
Silo-based/RVs	1000/2450	1218/6180
Mobile/RVs		188/ 350
Total ICBMs/RVs	1000/2450	1406/6630
SSBNs/SLBMs/RVs	34/608/5312	62/944/3676
Heavy bombers/weapons	360/5504	175/1240
Total delivery systems/weapons	968/13,266	2525/11546
START/1998		
ICBMs		
Silo-based/RVs	314/ 942	194/1940
Mobile/RVs	50 or 500/500	542/ 992
Total ICBMs/RVs	364 or 814/1442	736/2932
SSBNs/SLBMs/RVs	18/432/3456	18/312/1968
Heavy bombers/weapons	263/4113	150/2000
Total delivery systems/weapons	1059 or 1509/9013	1223/6900

that will deeply reduce Soviet and U.S. strategic attack forces while maintaining this "strategic stability" and the rough parity that currently exists. The most radical Soviet military reformers are calling for drastic reductions to the point where each superpower possesses only a few hundred weapons or possibly no nuclear weapons whatsoever.

CONCLUSION

In summary, recent events in the Soviet Union and Eastern Europe, particularly those of the past several months, have dramatically reduced the military threat posed by the Warsaw Pact. The Soviets and their allies have begun to decrease unilaterally the size and offensive capability of their military forces in Central Europe. More significantly, the Eastern European states are regaining national independence from Moscow. Clearly, the Soviets can no longer expect these nations to contribute forces to a Soviet-led offensive campaign. Moreover, Soviet forces are being quietly but inexorably pushed out of Eastern Europe. Even greater reductions in Soviet and East European forces appear likely if the new democratic governments in Eastern Europe succeed in consolidating their power and if NATO and the Warsaw Pact sign and implement a CFE agreement that produces parity between the two alliances in several key weapons categories. In addition, the likely conclusion of a START agreement in 1990 will significantly reduce the attack potential of the U.S. and Soviet strategic nuclear offensive arsenals while preserving the stable deterrent relationship between the superpowers based on their mutual vulnerability to devastating nuclear retaliation.

Despite the marked reduction in the Warsaw Pact threat, the U.S. should work to preserve the NATO alliance and to continue to deploy U.S. forces in Europe, albeit at much lower levels. This will help to maintain stability at a time of massive political change and to sustain an active American voice in European affairs that are vital to our security. At the same time, the west should, in my view, intensify its efforts to promptly conclude START and CFE agreements that would significantly reduce the forces on both sides over the next few years. The United States should also proceed to restructure, prudently modernize, and to reduce its forces as, but not before, these agreements are implemented.

Even if the democratic revolutions in Europe are sustained and if we succeed in achieving extremely ambitious arms reductions, the Soviet Union will retain substantial numbers of very capable strategic nuclear and theater conventional forces. The United States and its Western partners will need to adjust their collective forces and military strategy appropriately to ensure successful deterrence and defense in the new security environment.

Mr. OBEY. Thank you.
Dr. Hamburg.

DR. HAMBURG'S OPENING STATEMENT

Dr. HAMBURG. Thank you, Mr. Chairman.

I am very pleased to meet with this important Committee and this distinguished panel. It is quite an opportunity.

I think what we are all talking about is trying to take advantage of historic opportunities that face us.

I want to talk briefly about aid to Eastern Europe and the Soviet Union, drawing on private sector models, mostly supported by foundations. These models may, in some cases, be useful to government, especially where a larger scale is needed.

EMERGING DEMOCRACIES AND INSTITUTIONS

I certainly concur with what we have heard about the truly revolutionary events of 1989. The contagion of democracy has spread to every continent. Remarkably, these developments have been almost entirely peaceful.

But, these are only the beginnings of democracy in most of the nations of Eastern Europe as well as the Soviet Union. Now, as we add South Africa and Nicaragua, these are quite fantastic and wonderful developments. But it is a very long, hard road to go. Most of these countries are trying to build democratic institutions virtually from scratch. Some of them have the luxury, as it were, of strengthening some rudimentary democratic institutions or drawing upon some modest experience from the past.

But, on the whole, this is a matter of creating new institutions. In my judgment, the greatest help the United States can give is to work closely with these countries in a spirit of genuine collaboration and mutual respect to build democratic institutions.

We do have the great good fortune of two centuries of experience in strengthening our own institutions. With all the problems we face and without being smug or complacent in any way, our experience is very much desired by those countries and can be very useful. We should also be quite active in our aid programs in calling attention to other democratic models. The nations of Eastern Europe may borrow here and there and adapt in various ways in building their democratic institutions.

My remarks draw heavily on some material that I have submitted to the Committee that I hope will be helpful—not only a longer, personal statement of my views, but also the summary of a conference we held at the Carnegie Corporation in mid-December on aid to Poland and Hungary. There is a catalogue of both public and private sector initiatives during 1989 directed to those two countries. And there is what I think is a useful summary of the meeting. I hope the Committee will find those helpful. I just want to give you a very few highlights here.

EAST-WEST FOUNDATION ACTIVITIES

One way in which foundations have been active during the 1980s, and especially in recent years, has been to bring together mixtures of scientists, scholars, and other experts from East and West—in various combinations from the United States, Soviet Union, Eastern European countries and Western European countries—on topics initially of avoiding nuclear war, of crisis prevention, risk reduction, and particularly since Gorbachev, on broader issues of East-West relations. A major part of these discussions among multifaceted experts has been to help East Europeans move toward freedom and pluralism without triggering violent explosions. In my submitted testimony, I give a number of examples of such enterprises supported by foundations through a variety of institutions, so I won't take the time to go through those now, although I would be happy to answer your questions about them.

Some of the expert meetings have been devoted primarily to Eastern Europe, others primarily to the Soviet Union. One effect they have had is to build strong relations with the scientific and scholarly community in these nations on critical issues of a military, economic, and political nature, as well as science and technology for development.

One fascinating aspect is that our principal Soviet counterparts in the scientific and scholarly community prior to Gorbachev, have in some cases become major advisers to Gorbachev and other top Soviet leaders. Recently, some have also become leaders in the Supreme Soviet, which is one of the key institutions of democratic reform in that country.

In terms of Eastern Europe, one of the most significant thrusts of discussions in some of these expert groups has been to try to help the Soviets to understand that it is in their own interest to end the coercive nature of their relationship with Eastern Europe. Western participants have been able to point out to the Soviets that the damage during the Cold War was not only in their relations with Eastern European countries, but also with the United States and with Western Europe. It was very serious damage; indeed, that was the way the Cold War began. These discussions considered the models of Finland and Austria, the kind of relationships the Soviets have had with them, and how such models could be useful for all of Central and Eastern Europe have been taken up with Soviet Experts in such discussions.

How much influence those discussions have had it is very hard to say, they were certainly worthwhile and constructive. They moved from being very sensitive and contentious in the first phase some years ago, to a constructive, problem-solving mode in the later phase. Today, both in the private and public sectors, it is possible to conduct such discussions among a network of experts in a variety of fields and in a variety of countries, East and West. A wide range of political, economic, military, cultural, scientific, and technological matters can be discussed through the communication networks that have developed among these experts.

Another kind of foundation activity has been the creation of new, albeit small, foundations in Eastern Europe and the Soviet Union that provide some degree of entrepreneurship in the nonprofit sector, some generation of new ideas, and some facilitation of contact with Westerners. For example, the Rockefeller Brothers Fund and the Ford Foundation helped to establish a few years ago the Foundation for the Development of Polish Agriculture, a multinational organization which provides technical assistance to private farmers in Poland.

Incidentally, let me say that this kind of activity—both the freeing of private sector initiatives in Eastern Europe and the cooperation of expert groups to provide analysis of the very difficult questions of building democratic institutions and reforming the economies—was given the very strong reinforcement by President Havel of Czechoslovakia last week. I had the opportunity to talk with him about these matters. He feels, for example, that the main thing the West could do for the Soviet Union is to pursue expert, analytical work in political and economic domains of reform.

In the December 1989 meeting at Carnegie, of which I submitted a summary, there was strong consensus on the urgent needs in Eastern Europe and the Soviet Union. There is the sense that the next few years provide a great opportunity, but it will not be there indefinitely. We cannot assume that these political and economic transformations will take place successfully. They may well fail, not only in the Soviet Union, as has been pointed out, but in the Eastern European countries as well. If the opportunity is missed, the adverse consequences might well be truly severe.

NEEDS OF EASTERN EUROPE AND SOVIET UNION

So, in formulating either private or public aid activities, it is worth keeping two key considerations in mind. First is responding to the intense needs associated with a drastic transition, for example, food aid or help with immediate conflict resolution. I understand you heard from Jeffrey Sachs yesterday about the drastic transition in Poland. That is a very good example of a situation in which there are urgent, immediate, ongoing needs that have to be met to give that transition a decent chance of success.

Second is establishing as soon as possible the basis, for long-term institutions: establishing democratic rules and procedures; building technical capabilities; and strengthening problem-solving capacity within those countries over a wide range of functions, especially with respect to conflict resolution, because there are so many potentially deadly conflicts just below the surface and sometimes at the surface.

There was agreement among the foundations who have been active in this field that leadership for a new era is crucial. There are a lot of intelligent, well-educated people in those countries. But they have under powerful constraints in a very different sort of system. They have been cut off from important bodies of knowledge. We hear over and over again about the importance of management training to operate a modern economy; of technical training in a variety of spheres pertinent to the modern economy; of leadership training for democratic political and economic institutions. The level of experience in these areas is very, very low in most of Eastern Europe and the Soviet Union.

One of the fundamental needs for modernizing the economy, which probably has not had sufficient attention, is in science and technology. There is no way you can have a modern, competitive economy in the interdependent world economy of the next century without some decent capability in science and technology. Even if it is not going to be primarily a high-tech economy, and even at a more moderate range of technological complexity, science and technology are crucial. Unfortunately, these countries have had very little experience with these matters.

The openness of democracy greatly facilitates new ideas, new information, and new techniques. It is not that science and technology are totally shut off in dictatorships, but they are greatly hampered, and especially with regard to the civilian economy. So, these countries are going to have to find a way to hook up with the world scientific community, particularly the very large and dynamic American scientific community, in order to develop a modicum of technical competence consistent with a modern economy and a democratic society.

This is an area in which both government and private aid could be enormously helpful. Indeed, I think the scale of it is likely to be great enough that a government role will be crucial. There are many institutions that can help: the government's own national laboratories and its other scientific institutions; many universities, especially the research universities; comprehensive scientific organizations, like the National Academy of Sciences and the American Association for the Advancement of Science. These institutions can contribute a great deal. I think government support as well as private support will be necessary.

American universities have a special, multifaceted role to play in aid to these countries. They have a very high standing in the world at large. Certainly in Eastern Europe and the Soviet Union there is a great desire by people in many fields and levels of experience to come and spend a substantial block of time in these universities. Students, scientists, scholars, and administrators want to come. And we need to facilitate that. Such experiences tend to have a profound, indeed lifelong, impact on their outlook and their values. We have seen that in the early days—even pre-detente—the outlook of the few Soviets who could come here was greatly changed by the experience. Some special fields of practical, near-term significance for Eastern Europe would include agricultural extension, public health, and business and American universities have much to offer in these areas.

DEMOCRATIC INSTITUTION BUILDING

I want to underscore that building democratic institutions is absolutely essential and that there are the various collaborative ways in which we can help. Andrei Sakharov put great emphasis on the necessity for democratic institutions in the Soviet Union because of the inherent openness involved. He said the Soviet Union cannot be a reliable partner for the United States or other countries, and it cannot be depended upon or be trustworthy until it has pervasive openness that goes with the building and sustaining of democratic institutions. His passing was a great loss. He left, incidentally, a draft constitution of a Western variety. It is extremely interesting and should be pursued.

The democratic institutions must have explicit mechanisms for resolving conflict and for accommodating diversity. Certainly, in the Soviet Union and Eastern Europe, there is extremely dangerous potential for conflict among the diverse groups within and between countries.

Now, the new parliamentarians in the Soviet Union and Eastern Europe urgently want a lot of contact and want to learn from their counterparts the United States Congress and from other Western parliaments. We ought to facilitate that. Indeed the Supreme Soviet is one of the principal focal points of democratic reform in the Soviet Union.

There is a great need for research services for the new parliaments, something akin to the Congressional Research Service and the Office of Technology Assessment. Guidance on such vital functions as how to operate a committee, and how to conduct oversight is badly needed. Of course, the parliaments and the administrations very much need independent, technically competent economic analysis. This huge transformation of their economies cannot depend on the very limited economic competence they now have or any kind of party line mythology. They need the creation of independent institutes and centers, connected with universities or not, in their own countries to work on their own economic problems.

OTHER NEEDS IN EASTERN EUROPE AND SOVIET UNION

In connection with the economic transition, they also badly need broad-scale public education, and some of that can be fairly expensive. For example, the transition of Western Europe after World War II, and the paths by which Western Europe receive its present prosperity might well sustain hope in Eastern Europe about the possibilities of coming from the depths of poverty and technological backwardness to modern and prosperous economies.

Because of the potential for violence involving the resurgence of old animosities, we also need to be thinking about crisis prevention. We need to have expert groups, both in government and out of government, looking at the principal conflicts in the most dangerous hot spots in Eastern Europe and the Soviet Union, and to be thinking in terms of constraining violence and coping with situations that might erupt.

In the same vein, we should look at the economic, political, and military functions of multilateral organizations. For example, it is quite interesting how the Group of 24 sprung up. In a short time, less than a year, this organization is functioning pretty well to provide aid for Eastern Europe. I think our administration played a very constructive role.

There is also a lot of interest expressed by President Havel and others about regional cooperation. Italy, Austria, Hungary, Yugoslavia, and probably Czechoslovakia are exploring a mechanism for regional cooperation on environmental problems, technology transfer, telecommunications, and transportation. This is an interesting model that we need to understand and try to facilitate.

We have to wrestle with reconsidering multilateral organizations in light of the emerging world economy and the role of broader integration in comprehensive European security. What will happen in an environment where the Warsaw Pact is an empty shell? At the same time, the functions of NATO are changing. So, we must ask ourselves what will we need in the way of a comprehensive European security organization? We may have to be light on our feet about shaping multilateral organizations that are specifically adapted to the requirements of the new world that is emerging.

A very important role for aid is in grass-roots work at the community level in nurturing entrepreneurial skill. Many informed people believe that small business enterprises can get off the ground much more rapidly and effectively in these countries than very large firms can. In the non-profit sector, there are examples throughout the world of grass-roots organizations that are promoting the health of the community, promoting education in the community, and promoting small-scale economic development in the community. These activities, both in the for-profit and non-profit sectors deserve a lot of stimulation, encouragement, and support from international aid agencies. The skills involved are not only intellectual and technical skills, but organizational skills, and particularly in functioning on a democratic political and economical basis. All that implies the growth of a civil society, which is badly needed in the post-communist world of Eastern Europe and the Soviet Union. International aid can build networks of similar organizations and activities across national boundaries. For example, in the public health field, there are very important opportunities of that kind.

Finally, all kinds of exchanges can occur. We probably have underestimated the power of Western, and particularly American, culture. The societies in general, beyond the governments, can have influence through exchanges. But often the governments have to facilitate those exchanges—scientific and scholarly, technical and cultural. There are many cultural domains, in the arts, in religion, in the media, in sports. Community adoptions and partnerships have also worked well in some cases, as have people-to-people exchanges and tourism Such activities can have the effect, over time, of strengthening democratic institutions, and changing basic attitudes.

I hope this conveys, Mr. Chairman, the broad array of constructive possibilities that do exist with Eastern Europe and the Soviet Union for aid that is truly humanitarian and highly congruent with American values. There is a real sense in which our values have emerged in the best possible way. And now we have the opportunity to follow through, to see to it that the triumph of those values does not collapse under the terrible pressures that exist in these countries. We don't want to miss the opportunity that is now before us.

Thank you very much.

[The prepared statement of Dr. Hamburg follows:]

TESTIMONY FOR HOUSE COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

FOREIGN OPERATIONS SUBCOMMITTEE

February 28, 1990

"Aid to Eastern Europe and the Soviet Union"

David A. Hamburg, M.D.

President

Carnegie Corporation of New York

It is a privilege to appear before this distinguished committee. The work of this committee has a great bearing on the ways in which the United States works with other countries throughout the world and therefore with our standing in the world. Surely this must be one of the most critical moments in the history of the committee's deliberations, given the extraordinary events of recent months in Eastern Europe and the Soviet Union. Now we must add South Africa to the list of dramatic developments. It is difficult for me to imagine a time when any comparable committee would have had such unprecedented opportunities and truly formidable responsibilities. Perhaps the immediate post-World War II period is the closest analogy.

It is certainly not an exaggeration to speak of these developments as revolutionary events. The sweep of history may well put them in the same category with 1848 and 1789, years of upheaval and landmarks in world transformation. We of course have our own revolution to look back on. It is not so very long ago that we celebrated our momentous bicentennial. Our founding fathers had the extraordinary wisdom and foresight, nearly unprecedented in human history, to lay out a framework for democracy--political and economic freedom along with a strong sense of interdependence and mutual aid. These values have served us very well indeed for more than two centuries and they have become a beacon in the world at large. Now, the contagion of democracy which we did so much to inoculate has spread to every continent. It is not equally successful everywhere, but it has made more headway during the past year than any other within memory. To make this all the more extraordinary, these democratic developments have been almost entirely peaceful.

But these are only the beginnings of democracy in most of the nations of Eastern Europe as well as the Soviet Union and South Africa. We have had more than two centuries to build our own democracy and still we have plenty of problems. Of course, the emerging democracies around the world can benefit from our experience as well as that of other long established democratic nations, particularly those in Western Europe. But they have to make critical choices in the near future that will have profound long-term consequences. Indeed, as we sit here today, such choices are being made. These involve the drafting of constitutions, establishing the rule of law, creating an independent judiciary. They involve staking out the powers of executive, legislative and judicial branches as well as their relations with each other. They involve a shift toward a market economy with an effort to balance considerations of efficiency and social justice. They involve moving from highly centralized, command decision making to more widely dispersed and private decision making. They involve the conduct of elections, the creation of free political parties, mechanisms to oversee government, and ways to cope with the longstanding hostilities that are now coming to the surface. In short, these nations are trying to build democratic institutions from scratch, or else greatly strengthen democratic institutions that have been rudimentary until now. In my judgment, the greatest help the United States can give is to work closely with them in a spirit of genuine collaboration and mutual respect to build democratic institutions.

My remarks today draw heavily upon the experience of Carnegie Corporation and several other foundations that have been undertaking such enterprises with Soviet and Eastern European counterparts in recent years. I will submit for the record two documents that I hope will be concretely helpful to this committee. One is a summary of a meeting held at the Carnegie Corporation on December 15-16, 1989. It is entitled "Western Proposals for Assistance to Poland and Hungary." This meeting considered initiatives underway in both the government and the private sector, taking into account both for-profit and nonprofit segments of the private sector. Also, I submit a longer document that was prepared for the conference. It is a fairly comprehensive statement of initiatives undertaken through the end of 1989. Incidentally, a similar meeting was held on January 4 under the auspices of the Ford Foundation on Czechoslovakia. Its conclusions were similar. Events are moving so rapidly that it would now make sense to have comparable meetings on other Eastern European countries.

For several years, American foundations have been pursuing opportunities to build democratic institutions in the context of peaceful cooperation. Such efforts in Eastern Europe are closely related to foundation initiatives with respect to the Soviet Union, especially since Gorbachev came to power. Clearly, Gorbachev's policies have had a profound effect upon the developments in Eastern Europe. Indeed, some foundation-sponsored activities have tried to encourage such policies in recent years by free exchange of ideas between Eastern and Western scientists, scholars and other experts.

First things first: several foundations involved in this field, Carnegie included, have sought to reduce the risk of the ultimate disaster, nuclear war, and have seen Eastern Europe as one of the leading candidates for crisis or worse. Therefore we have generally supported efforts to increase thoughtful communication between East and West, to deepen mutual understanding, to improve skills of conflict resolution, to prevent crises and to help the East Europeans to move toward freedom and pluralism without triggering violent explosions.

How have we tried to work toward these goals? Let me briefly describe one major mode of foundation activity directed toward this end.

Foundations have been active in recent years in supporting projects that bring together scientists, scholars and other experts from East and West--various combinations of United States, Soviet, Eastern European and Western European--in order to examine in some depth topics of this sort. Among the foundations active in this kind of work are Carnegie, Ford, MacArthur, various Rockefeller philanthropies, and the W. Alton Jones Foundation.

Let me briefly give a few examples to convey the flavor of such enterprises, supported by foundations through a variety of institutions--universities, research institutes, international scholarly organizations, the National Academy of Sciences and others. One interesting example is a project conducted by the Institute for East/West Security Studies. This institute has fostered wide-ranging contact between American and East European scholars. It arranged the first long-term stay of East European scholars in the United States. The impact of these scholars on their return to Eastern Europe has been impressive. Another project of this institute made possible a substantial dialogue among experts and public figures from the United States, the Soviet Union and Eastern and Western Europe on conventional arms control. This led to a very well documented book entitled "Conventional Arms Control and East/West Security." The senior editor of this volume, Robert Blackwill, is now one of the high-ranking officials of the National Security Council.

Another interesting example is provided by foundation grants to the Aspen Institute that have made possible a continuing series of in-depth meetings on East/West relations, linking scholars with policymakers--the latter being mainly members of the United States Congress from both houses and both parties who have major responsibilities in foreign and defense policy. In

1987 and again in 1989, one of these meetings was devoted primarily to Eastern Europe. In so doing, they considered in detail the recent history of Eastern Europe, the current ferment, and policy options of Western nations in relation to the exceptional emerging opportunities.

Another interesting example involves a conference held in July, 1988 under the auspices of the International Research and Exchanges Board, a private group that promotes much scholarly interaction with the Soviet Union and Eastern Europe. It sponsored a remarkable three-day conference entitled "The Place and Role of East Europe and the Relaxation of Tensions Between the U.S.A. and the U.S.S.R." The participants were leading scholars from the United States and the Soviet Union who have focused their studies over the years on Eastern Europe. For the first time ever, the Soviets admitted the long-term failure of their policies in Eastern Europe and sought new ways of thinking about Soviet relationships with Eastern European countries. Participants in the meetings from both sides explored ways in which the United States and the Soviet Union might cooperate to foster the well-being of the peoples of Eastern Europe. These scholars recognized the unique significance of Eastern Europe in relation to U.S.-Soviet ties. Since the origins of the cold war could be traced to the conflict engendered in Eastern Europe, so too the resolution of this conflict in the foreseeable future would be crucial to improving U.S.-Soviet relations in any fundamental way.

For the long term, one of the most significant thrusts of such discussions in meetings of this sort has been to help the Soviets understand that it is in their own interest to end the coercive nature of their relationship with Eastern Europe. Historically, they have elicited a great deal of hostility and have jeopardized their own well-being by repressing Eastern Europe. The damage is not only in their relations with Eastern Europe but with the democracies throughout the world. The models of Finland and Austria have been examined with Soviet experts in such discussions, showing how everyone would be well served for the long term by taking those models seriously for all of Eastern and Central Europe.

Now, it is much more possible to explore such matters freely and deeply than it ever was before--with the Soviets and the East Europeans. A wide variety of political, economic, military, social, cultural, scientific and technological matters can be discussed by groups of experts put together in many combinations and permutations, depending upon the specific purpose at hand. My point is that the models exist, and indeed they were able to accomplish a good deal in far more difficult times. Today the networks of communication among experts in many fields can help the Soviets and East Europeans to build democratic institutions, greatly diminish the risk of serious conflict, and achieve an economic revival. This approach is highly congruent with requests made last week by President Havel of Czechoslovakia.

Let me very briefly mention another mode of U.S. foundation activity--the creation of new foundations that focus squarely on the emerging opportunities in Eastern Europe and the Soviet Union. One interesting example is the Soros Foundation which has created an active grant-making program in Hungary and also in the Soviet Union with offices in each country. It is now actively exploring additional sites of activity as well. The main thrust of its work is to stimulate individual initiative and enhance East/West contact.

Several American foundations have helped to establish the new International Foundation for the Survival and Development of Humanity. The mission of the foundation is to promote international cooperation on global problems including the strengthening of democratic institutions--especially in the Soviet Union. In 1988 the Foundation's entry on the American scene was highlighted by Andrei Sakharov's first-ever trip to the United States.

Rockefeller philanthropies and the Ford Foundation recently helped to establish the Foundation for the Development of Polish Agriculture, a multinational organization that provides technical assistance to private farmers in Poland. Similarly, the Sabre Foundation has created a scientific assistance project. It obtains donations of books from American publishing firms and distributes them in Hungary and Poland, especially for medicine, agriculture and the teaching of English.

Time permits only these few examples. Others are given in the accompanying documents that I have submitted. I hope these will be helpful in practical ways to the committee. The remarkable fact is that, in the few years since these opportunities have opened up, American foundations have moved rapidly to take advantage of them. Foundations are the venture capital of the nonprofit sector. Working with the government and the for-profit sector, foundations can help more in the years ahead to foster democracy and diminish the nuclear danger.

In the recent Carnegie meeting, and other consultations we have held on this subject, there has been a strong consensus on the urgency of the next few years in Eastern Europe and the Soviet Union. These years provide a rare and special opportunity. If the opportunity is missed, adverse consequences might well be severe. Therefore, in formulating either private or public aid activity, it is certainly worth keeping two considerations in mind: 1) responding to intense needs associated with drastic transition--e.g. food aid; help with immediate conflict resolution; 2) establishing as soon as possible the basis for long-term institutions--democratic rules and procedures; building technical capability; strengthening problem-solving capacity over a wide range of functions.

Leadership for the new era appears to be sparse even though there are many highly intelligent and well-educated people. They have functioned in a different sort of system and so they will need a great deal of help in management training to operate a modern economy; technical training suitable for the upgrading of their economies; and leadership training for democratic political and economic institutions.

Among the many virtues of democracy, one that is often taken for granted is the fostering of scientific research and technological innovation. The openness to new information and ideas that characterizes a democratic way of life is singularly appropriate for the advancement of science and technology. To a certain extent, countries emerging from dictatorships are entering a new world in this domain. Although they have some scientists of world-class distinction, the scientific and technological community is generally underdeveloped. Each country will have to select areas in which the need is greatest and also identify distinctive economic opportunities. The modern world economy depends to a great extent on scientific and technological competence. Therefore, the emerging nations will need to find ways to link with the world's scientific community, and especially the American community which is so large and dynamic. To some extent, they will have to develop internal capability, but the smaller countries will have to be selective about that development in light of their own particular circumstances. Above all, technical competence gives them the capacity to deal directly and effectively with their own problems.

Many institutions in the United States can be helpful in this regard. Certainly the government's scientific institutions have a major role to play. So too the universities, foundations, and major scientific organizations such as the National Academy of Sciences and the American Association for the Advancement of Science. All of these institutions have some activity in this field and could rapidly enlarge their work but they will need some government support as well as private support to do so. Especially important is to establish strategic bodies in each country or region to consider science and technology for economic and social development. That is, they need to strengthen functions comparable to those performed by the National Research Council in this country.

American universities have a high standing throughout the world. A large proportion of enrollment comes from abroad. Students, scientists and scholars from East Europe and the Soviet Union are eager to come here and particularly to spend a substantial amount of time. Such experiences tend to have a lifelong impact on them with respect to ideas, skills, values and outlook. It is worth a major effort to facilitate this kind of opportunity.

The Soviet Union and most of the East European nations do not have much successful experience with democracy. Czechoslovakia is an outstanding exception. Unfortunately, there is a long history throughout the region of many virulent prejudices: religious, ethnic, and national. Often these prejudices have provided the breeding ground for hatred, and hatred in turn has provided many justifications for violence. The context is one of strong authoritarian tendencies for centuries. Therefore, the building of democratic institutions is absolutely essential, both for the welfare of the people in the region and for their relations with other countries. Andrei Sakharov emphasized that democratic institutions and their inherent openness were essential to making the Soviet Union a reliable partner in international relationships. Democratic institutions must explicitly be built in ways that accommodate diversity and include visible mechanisms for conflict resolution.

The new parliamentarians of the Soviet Union and Eastern Europe are eager for contact with their counterparts in Western parliaments. Indeed, the new Supreme Soviet seems to be the principal focal point of democratic reform--in addition to Gorbachev himself and some of the academic institutes. The Supreme Soviet is clearly looking to the United States Congress for guidance and friendship. Each emerging democratic institution will have to make its own selection from the various models available. But aid from the West should be vigorous about providing the ready availability of democratic models in the United States and elsewhere for guidance about rules, procedures, patterns of organization, oversight and all the rest.

Similarly, there is a great need for research support for the new parliaments. It is my understanding that the Library of Congress is helping the Soviet parliamentarians to create something akin to our Congressional Research Service. An entity similar to the Office of Technology Assessment would also be helpful. Such efforts deserve intensive support. Given the enormous difficulty of their economic transition, there is also a great need to develop independent economic policy research institutes or centers. They should be broad enough to include a variety of perspectives including history, culture, psychology and various aspects of business as well as basic economics. This is because these huge transitions are necessarily multifaceted. They involve overcoming longstanding attitudes, ingrained habits of behavior and obsolete institutions.

In this context, it is striking to note the growing worldwide awareness of the linkage between political and economic freedom. Moreover, there is widespread concern that economic failure might undermine the fragile democratic institutions even where many good intentions exist. How is it possible to get from a highly centralized, command economy to a market-oriented economy? What is required to make markets work under conditions of a given nation and region at this time? That is, there is a need to understand not only general principles but specific cultural attributes. An important component is public education. The "cold turkey" drastic adjustment is now underway in Poland and involves multiple changes at once. While Poland provides considerable goodwill, nurtured by Solidarity and the Catholic Church, other countries do not have such bulwarks. In any event, there are ample indications from Poland of the pain associated with this drastic transition. Therefore, one useful function of aid in the near-term would be to help with broad-scale public education. For example, the experience of Western Europe in the post-war period, and the paths by which Western Europe got to its present prosperity, might well sustain hope in Eastern Europe during this difficult time. In many ways, international moral support for the reform governments is valuable.

In the emerging atmosphere of greater freedom, indeed even the intoxication of it, we have already seen in several parts in the Soviet Union the potential for violence involving the resurgence of old animosities. There is still an enormous concentration of multifaceted firepower in Eastern Europe, Central Europe and the European portion of the Soviet Union--including vast numbers of nuclear weapons. It is all too easy to forget that one nuclear weapon of modest size, the kind we hardly take seriously any more, would be equivalent to the bomb that destroyed Hiroshima. The possibilities of very serious terrorism exist in such a conflict-ridden area, heavily laden with weapons of all kinds. We see politics in the streets with much pent-up anger and the desire for revenge. In this context, it is useful to think in terms of crisis prevention and crisis management. It is worthwhile for expert groups, both within the United States and of international composition, to anticipate major contingencies. We need to develop a habit of thinking in terms of constraining violence, fostering conflict resolution, facilitating communication and minimizing nasty surprises. For these purposes, we need mechanisms in place to deal intelligently with the flow of events and to cope with surprises when they do occur. We need to support a variety of studies, exchanges and meetings to address such problems. The issues involve a conjunction of economic, political, psychological and military factors. Therefore, it seems reasonable for the National Security Council to stimulate and coordinate this activity from a governmental standpoint. From a nongovernmental approach, foundations can support such work based in universities and research institutes; can convene mixtures of government and nongovernment experts to address these dangerous problems; can convene American and other nation's experts as needed.

It will be useful to stimulate thinking about multilateral organizations, in and around Europe. Such organizations will have to deal with a mix of economic, political, psychological and military functions. It is important to sort out as quickly as possible what organization is promising for what purpose. What are the assets and limitations of each multilateral organization that currently has some functional utility for Europe? Where there is a specific need, can a particular institution be strengthened to adapt itself to the emerging circumstances? There is now considerable interest in extending the functions of the Helsinki process because it has the capacity to cover all of Europe and then some. It is remarkable how rapidly, since last summer, the group of twenty-four has arisen and has functioned reasonably well to provide aid for Eastern Europe. We have also seen indications of regional cooperation newly emerging: for example Italy, Austria, Hungary and Yugoslavia are exploring a mechanism to cooperate in telecommunications, transportation, and the environment. Probably Czechoslovakia will soon participate. There is a good deal of discussion about the reformulation of NATO; and about strengthening the functions of the European community and moving toward more effective economic integration.

There is a strong rationale for utilizing the dynamism of the democracies to reconsider multilateral organizations in light of the emerging world economy and the role of broader integration in comprehensive European security. In the highly technical, interdependent world economy of the next century, there will be an unprecedented flow of people, capital, information, and ideas around the world as never before. The speed, scope and complexity of these changes almost defy the imagination of prior centuries. They will require a variety of modes of international cooperation.

To be effective over the long term, especially in view of the incredible destructive power of modern weaponry, such cooperative mechanisms must overcome traditional prejudices and ethnocentrism that have historically led so often to hatred and violence. There is a sense in which the old Europe is obsolete but violent remnants remain. They could be especially dangerous in time of severe economic recession and of political crisis of whatever origin. So there is a great need for active exploration by governments, and also of independent analysis, to examine the frontiers of psychological and economic change as well as the dramatic political reformulations now underway. The construction of explicit mechanisms of conflict resolution, and the development of skills in their use, is a vital necessity.

On the economic side, one of the urgent needs is for entrepreneurial skill in establishing small business enterprises. Government and foundations can stimulate the expertise, spirit and funding to launch such efforts. American citizens of Eastern European origin can be particularly helpful in this regard.

Attention can usefully be devoted to grass roots organizations, both for-profit and nonprofit, in the private sector. There is a need for small-scale organizations of a nongovernmental character on a nationwide basis in Eastern Europe and the Soviet Union. The nodal points will be different in different countries and regions. Unions, churches and cooperative activities of various kinds can provide a base. Such organizations can be devoted to strengthening health of the community, improving educational opportunities, or undertaking economic development. They can build capability step-by-step, group-by-group. Efforts to acquire constructive skills on almost any basis at the community level are worthwhile. So much is needed that has been suppressed or ignored under dictatorial governments. The skills needed include not only intellectual and technical ones but also organizational skills, particularly with respect to functioning on a democratic basis. Taken together, such community organizations and widely distributed basic skills can lead to the sort of social invigoration that gives people the spirit and hope to pursue opportunities in a free society.

By the same token, such grass roots, nongovernmental organizations imply necessarily a lesser dependence on government and the growth of a civil society. Such activity furthermore implies an accommodation of diversity, since different communities will proceed in different directions. These grass roots organizations tend to lead to a better balance of private and public mix in the economy and the society. In this way, individual communities, no matter how poor, can lay the foundation stones for a future viable economy and democratic society. The stones are intrinsically useful step-by-step in the foreseeable future and provide a path to a much better society in the longer-term.

Sometimes it is useful for international aid to build networks with similar activities in other regions of the same country or across national boundaries. For example, efforts to build community organization and public education in the service of health are now spreading worldwide. There are many points in common, even allowing for great cultural differences. So a sharing of information, ideas and material may well be useful on this common theme in health improvement across national boundaries. There is a good deal of experience in aid mechanisms for fostering such grass roots organizations in the developing world. For example, the Inter-American Foundation has had considerable success with efforts of this kind in Latin America. There are lessons to be learned from such experience.

In both the "big picture" activities such as analytical work on economic and political reform or on crisis prevention, as well as the "grass roots" activities in promoting education, health and economic development at the community level, there is much to be said for close cooperation with aid agencies from Western Europe, both public and private. There is a strong feeling of cultural identification as well as political affinity between the East Europeans and both the United States and Western Europe. Given the geographical and historical factors, it is natural that the West Europeans will play a major role, and in many cases the leading role. Yet there is certainly an important responsibility and opportunity for the United States.

Western societies have a strong impact on the Eastern European countries. Indeed, we may have underestimated until now the extraordinary fascination with which Eastern European countries view the West. Western societies can have an influence through exchanges: scientific and scholarly, technical, cultural. Many cultural links are attractive, for example, in the arts, religion, and media. Some community adoptions or partnerships have been undertaken and these could be extended. Certainly family ties can be facilitated. In some cases, large scale, people-to-people exchanges make sense where there are cognate interests and values. All this suggests the real possibility of Western societies drawing eastern societies closer, promoting understanding, improving communication, and generally working toward constructive relationships. Such efforts are likely to strengthen democratic institutions, political and economic; and they can help in conflict resolution.

I hope these examples suggest the broad array of constructive possibilities that exist for helping Eastern Europe and the Soviet Union in ways that are humanitarian and congruent with American values. It is a time of truly historic significance and we do not want to miss the opportunity.

Mr. **Obey**. Thank you.
Dr. Steinbruner.

Dr. Steinbruner's Opening Statement

Dr. **Steinbruner**. Thank you, Mr. Chairman.

I have a statement that I will submit for the record. Let me summarize its main points very briefly.

It is intended, with all due regard to uncertainty, to interpret what the changes we have seen mean, what changes they are likely to bring about in fundamental U.S. policy, and the implications of foreign assistance programs that are likely to emerge after some period of time.

BASIC FOREIGN POLICY CHANGES

I think that we have seen fundamental shifts in Soviet policy that will be enduring whatever the fate of immediate Soviet leaders and whatever the outcome of its increasingly turbulent domestic political process. We need to consider the implications of these things for ourselves.

I believe that these changes will be enduring because they are driven by external circumstances that are not in their control and are compelling them to alter this policy.

These changes have occurred in two important categories both of which have been discussed this morning. One is the need, from the Soviet point of view, to regulate military power much more extensively, in fact, than the currently projected agreements would do. These agreements reflect only two first stages in the underlying logic of the new Soviet security policy.

Secondly, and equally fundamental, the Soviets need to integrate themselves into the world economy, accepting its market-based principles as they do so, and also the necessity of fundamental, democratic political processes.

I think the Soviets have basically understood these imperatives. If they have not yet worked out all of the implications, they are quite well along the path in doing so. This development will alter the character of world politics quite profoundly.

These same pressures operate on the United States as well. Although I think we have recognized that they work to diminish confrontation with the Soviet Union, I do not think we have yet fully appreciated the degree to which they align our interests with the Soviet Union. That is not something that we are yet quite prepared to realize. But I believe that that realization is also in our future.

My expectation is that it will introduce two very strong, new themes into American foreign policy, one of which I would summarize as cooperative security. I think that we will be driven in our own interest into arrangements for substantially cooperating with the Soviet Union in regulating military power internationally, making our own defense a good bit more efficient than it currently is—that is, better, at lower force levels, and at lower costs. That is accomplished essentially by cooperating and exchanging information with the Soviet Union.

I believe the effort to implement cooperative security will dominate the decade and will alter the context of United States foreign policy very substantially. Economic engagement is also likely to emerge as a natural complement to cooperative security. Economic engagement refers to our own constructive response, if you will, to the Soviet attempt and their former allies' attempt to enter the international economy. Our economic posture toward Eastern Europe and the Soviet Union has been largely negative, reinforcing their own imposed isolation. It has been dominated by sanctions and restrictions.

In response to their efforts now to enter the international economy, we are going to have to switch the character of our policy to make it more constructive. That will be a major enterprise.

IMPLICATIONS FOR FOREIGN AID

Let me try to guess what the large implications for U.S. foreign assistance programs will be if, indeed, this is the track of the future.

First, it is very predictable that for a fairly substantial period of time there will be a truly major redirection of international investment resources toward the Soviet Union and Eastern Europe. Most of these will have to be private in character. There will have to be very substantial response from investment resources within these economies. But there will be a major public sector role for the United States and other Western countries to play, and our assistance programs will be affected.

In the first instance, I think we need better conceptualization of what our role is to be. It clearly requires some strategic consideration as to how we assist a transformation to market economies. Nobody has ever done this before. It is an extremely difficult thing to do. Nobody has a completely developed plan for doing so.

Now we are in the early stages of learning how to do this and we are going to need that conceptualization before we can act very well. That is probably the first requirement.

But I believe it is also predictable that a fairly large allocation of resources will be required to implement an effective conceptualization. This implies a dramatic, internal reallocation of our foreign assistance efforts, as well as our overall fiscal policy and defense policy. This is a problem that will probably be measured in tens of billions, perhaps hundreds of billions of dollars in magnitude. It is not one that we can walk away from.

The fact that it has global implications will make that all the more difficult. Clearly, the debt burdens that do threaten particularly the Polish and Hungarian economies are international problems and threaten many other economies as well. It will not be feasible or desirable to redirect resources to Eastern Europe and the Soviet Union at the expense of Africa, Latin America, or any other part of the world. Therefore, what we are talking about is a truly major fiscal alignment within the United States and an increase in attention, a dramatic increase in our attention to foreign assistance generally.

I realize that this is not an imminent prospect as far as this subcommittee are concerned, but I would say it is something that you had better start to think about.

I believe, as well, that the United States will probably, in the course of this, have to develop strategic conceptions as to how the public component of this investment flow can be best designed to accomplish the objectives of improving economic performance. That objective is of critical importance in encouraging democracy. Without vibrant, well performing economies, democracy will be in very serious trouble in Eastern Europe, the Soviet Union, or any other part of the world.

There is undoubtedly a great deal of wisdom yet to be developed. But I would call your attention to the leverage effect of what is being called infrastructure investment. Although I don't think we know as much yet as we ultimately need to, there is good reason to believe that certain things are particularly critical in tying any economy into the world economy, and that really is critical for the performance of any economy.

Transportation and telecommunications are clearly elements of infrastructure investment. They have to do with literal, physical connections of an economy to world productive activity. Most of the economies in Eastern Europe, the Soviet Union, and the developing world are very poor in the areas, and private sector investment will not to be able to compensate without substantial help. In general, that we are facing a big public sector investment requirement for developing the telecommunication and transportation infrastructure of the Eastern European and Soviet economies. That is the positive side of economic engagement.

There is also, a negative side in that we will also have to worry about the overall effect of these economies on global energy balances. Pollution control and energy consumption are likely to be major problems which the Socialist economies themselves are unlikely to handle. They will need a fair amount of international assistance. Again, that is a public sector concern.

Finally, let me note, as we imagine in this emerging world, there will very predictably be a set of issues having to do with the balance of responsibility among aid donors. I don't have to tell you that we are not alone among the countries that are being asked to respond, and that indeed our own aid programs are now in some calculations below those of Japan, for example.

However, I think there is a balance in the donor country programs, a better balance, that will need to be achieved. One can think about it in simple categories. Some part of foreign assistance has to do with what might be called "public good investments," which benefit economy generally. Others have to do with more narrowly defined commercial investments that benefit some private interests.

I think there has been a tendency for United States programs to concern themselves with the public good side of it, rather more than other countries do. There is a well known tendency for the Japanese, in particular, to concern themselves with foreign aid that is tied directly to national commercial trade interests.

I think in achieving an overall international balance, there will be an active discussion of this, and both sides will have to do some adjusting to bring about a more equitable, or at least politically more acceptable, division of labor.

Let me finish, then, by conveying a sense of urgency. I realize that the burden of my remarks takes you well beyond anything that will happen in this particular year or this particular budget cycle. So it is a sketch of a future and it may be difficult to imagine how you get there from where you are.

I only sort of suggest to you the image that emerges to me from my youth in Colorado, where I spent a lot of time hiking around the mountains, and not always on trails. When you are doing that, you spend a lot of time looking at exactly where your feet are because, otherwise, you can be on the ground in unfortunate ways very quickly. But if you don't stop and look around every now and then, you get yourself lost. Moreover, in getting yourself from where you are to where you want to be, you don't have an infinite amount of time. Darkness comes, weather comes, and bad things happen.

I leave you with this image. I think in the current foreign aid program, we are going along in normal channels and looking at where our feet are. Obviously there are compelling reasons for doing that.

But the burden of what I am saying is that under these circumstances, this subcommittee, this country as a whole, has to step back, look around a bit, and reorient itself quite a lot. We cannot conduct business as usual indefinitely. However we manage it, I think that there are compelling reasons, truly compelling reasons, for dramatically increasing our utilization of foreign assistance generally. This subcommittee carries the burden of working that out.

Thank you.

[The prepared statement of Dr. Steinbruner follows:]

Statement by

John D. Steinbruner

Hearings on New Directions and New Problems in Foreign Assistance

Subcommittee on Foreign Operations
House Committee on Appropriations

February 28, 1990

I am pleased to be able to contribute to the deliberations of the Foreign Operations Subcommittee on the U.S. foreign aid program. As is customary, I offer my comments solely as an individual and not as a representative of any institution or organization.

I know that the members of this subcommittee are as aware as I am that dramatic changes in world politics centered over the past year particularly in Eastern Europe have altered the context of United States foreign aid programs. I share what I understand to be the presumption of this subcommittee that these changes mandate a major redirection of thinking in the United States and ultimately a redesign of most aspects of American foreign policy, including especially our foreign assistance programs. I realize that it is very difficult to grasp the meaning of large events as they occur and that a great deal of spirited debate is likely to be necessary before settled judgments emerge. Nonetheless, in hopes of contributing to that process, let me offer an interpretation of what has happened and a few suggestions as to what the implications might be.

Basic Foreign Policy Changes

The revolutionary political changes that have swept through Eastern Europe in the past few months are a culmination, I believe, of fundamental changes in security and economic conditions that have been long in gestation and are irreversible in their basic effects. Military forces have developed to the point that agreed regulation is an imperative for reasons of safety and efficiency. Economic activity has been internationalized to an extent that severely threatens the development of any economy which remains isolated from the industrial world. Both trends have been understood by an unusually decisive political leadership in the Soviet Union and fundamental changes have been made to bring Soviet policy into alignment with them. These changes in policy have been enabling, indeed triggering conditions for the dramatic political shift in Eastern Europe and they have yet broader implications for global security and global economic relationships.

The main themes of the Soviet policy shift are military disengagement and economic integration. Each is backed by a very solid logic of national interest and is likely to endure whatever the political fate of immediate Soviet leaders. The Soviets obviously intend to preserve a basic deterrent capability but have recognized that their former policy of projecting a conventional weapons threat against Western Europe, or anywhere else outside their own territory, has become infeasible and counterproductive. Though the process is clearly moving more rapidly than they find comfortable, fundamentally they have intended to dissolve the alliance confrontation in Central Europe and to replace it with a cooperative security arrangement. The essence of this arrangement is to produce better security at lower force levels and lower cost both for themselves and for everyone else. The key to this efficiency is the acceptance of more limited, defensively focused missions and a greatly expanded exchange of information about force deployments, weapons production, and operational practices. That is, in fact, a compelling proposition and it is very likely to become the basis for a new international security order.

Economic integration is a companion theme in Soviet policy. It is based on a recognition that the stark economic isolation they have imposed on themselves has produced inferior performance as an inevitable consequence. The Soviets have accepted in principle that they must overcome this isolation and must adapt their economy to basic market principles in order to do so. Such a transformation is unprecedented, and there is no ready design for accomplishing it. The difficulties to be encountered and the degree of success achieved are very much open questions. The main line of policy is not. Integration into the world economy is a true imperative for the Soviet Union as it is for everyone else and that fact is also destined to be the basis for a new international political order.

These basic shifts in the policy of the Soviet Union driven by events they cannot alter imposes the ultimate necessity of equally fundamental changes in United States policy. We cannot preserve the military posture and standard politics of alliance confrontation if the Soviet Union does not play the role of dedicated adversary. We do not have the capacity to isolate the Soviet Union in economic terms if they are not committed to isolating themselves. Under emerging conditions cooperative security is so much in the United States' interest that it will have to come the central element of our security posture. Similarly, we will have to recognize our own overriding interest in extending market operations to all parts of the world. In support of that objective we will have to shift our traditional economic posture both towards Eastern Europe and towards the Soviet Union itself from the current emphasis on economic sanctions to one designed to encourage economic integration. For the United States economic engagement is a necessary complement to cooperative security.

Implications for Foreign Aid

These basic changes in American policy are at best only inchoately developed and their implications on the whole have not been specified. Clearly it requires some venturesome speculation to imagine what these implications will ultimately prove to be. For the sake of encouraging discussion, let me offer some suggestions.

As the process of economic engagement is recognized as a central element of the new international order, it will also become the focus of necessary investment, creating an entirely new and potentially very demanding objective for American economic assistance. I hesitate to attempt a specific estimate of the magnitudes that might be involved except to say that they are undoubtedly much larger than we are currently willing to contemplate. To date we have largely ceded the initiative on this subject to the EEC whose efforts have been focussed on the French proposal for a European Bank of Reconstruction and Development (EBRD) with capital assets on the order of $12 billion currently being discussed. Since the release of Soviet political control in Eastern Europe will almost certainly be accompanied by a large, rapid, reduction in the estimated $15 billion a year subsidies the Soviets have provided, the $12 billion figure for the EBRD is undoubtedly low even for the most immediate and urgent requirements.

There will predictably be many conceptual and practical issues that need to be resolved before there is any workable agreement on how to make investments that contribute productively to a transition to market operations. Standard economic principles will have to be judiciously tempered by an appreciation of their political consequences and that is an art that no one has securely mastered. When a viable conception is worked out, however, financial investment requirements on the order of hundreds of billions of dollars will almost certainly be envisaged and corresponding pressures will arise for a truly major reallocation of world investment resources.

Within the United States this will become not simply a matter of foreign aid as traditionally defined but more generally a question of basic security and fiscal policy. Cooperative security offers improvements in defense efficiency that might produce hundreds of billions of dollars in defense budget savings over a decade and thus potential United States contributions to an investment program does not appear to be infeasible in principle. We have not been in the habit of making such large reallocations of effort, however, and our ability to do so is obviously a major question.

The difficulty of this question will be intensified by the fact that the principle of economic engagement must be applied globally and not simply to the Soviet Union and/or Eastern Europe. Struggling economies in Africa, in Latin America, and elsewhere are also threatened with economic isolation but not because they have deliberately intended it. Many of them, burdened with obviously unmanageable debt, have already imposed considerable internal austerity in an effort to adjust to international market principles without as yet securing viable access either to financial or to product markets. That remains a problem yet to be solved. I do not believe it to be either morally or practically feasible to allow a surge in Eastern Europe/Soviet investment to occur solely at their expense. Balanced investment will be an important criterion for redesigned foreign aid program and a substantial price will be associated with that criterion, including very likely some internal reallocation. Current aid allocations are more concentrated in the Middle East than emerging strategic conceptions are likely to consider sustainable.

I also believe that the rationale and specific design of U.S. aid programs will be affected by the changing context as the political alignment of the recipient states becomes less important and the question of economic performance more so. There will be, I believe, a predictable demand for a plausible strategy as to how direct aid and facilitated investment mechanisms can assist sustainable improvement in economic performance. In that context the importance of infrastructure investment is likely to be recognized.

Effective connection to the world economy requires telecommunication and internal transportation networks that are typically underdeveloped in the less robust economies. By their very nature, development of these areas requires substantial public sector initiative. Pollution control and energy efficiency are similarly emerging as important constraints from an international economic perspective. These also require judicious regulation and some public investment. Investment directed to these categories is likely to emerge as a promising means of facilitating practical connections to the international economy and that objective itself is likely to become a prominent element of foreign assistance policy.

To the extent this is true, then the political conditions for encouraging infrastructure investments will be sharply debated. In particular the propriety of making infrastructure investment in Eastern

Europe and ultimately in the Soviet Union will be a contentious issue. That issue has arisen in the discussion leading to the creation of EBRD. Current U.S. policy is quite negative on the subject, but that natural, traditional reaction is likely to be subjected to some searching reflection.

Finally let me explicitly mention what you already know: namely, that the balance of responsibility among the providers of the various forms of foreign assistant will be an increasingly sensitive political issue. Whatever the magnitude and design of U.S. foreign aid efforts, they will not be adequate by themselves to accomplish their central objectives and the question of coordination with other national and international efforts will be increasingly important. As the members of this subcommittee are no doubt aware, the efforts of other countries, particularly of Japan, have become more important in recent years but have been more closely associated with commercial trade of national origin. The question of international coordination is bound to make the balance of international responsibility a prominent question with pressures to harmonize national aid programs to a greater extent. Either U.S. aid programs will acquire more connection to U.S. export trade or other national programs will adopt some of the more general functions. More likely both adjustments will be made. The relative balance of national aid composition is an open issue destined to receive a great deal more attention.

These remarks are clearly meant to focus your thoughts rather than to settle them. I hope they are helpful in that regard.

Mr. **Obey**. Thank you.

Thank you all very much.

ADMINISTRATION'S BUDGET REQUEST

Let me simply start by observing that the Administration's budget request for this year is very largely a replication of their request to us for last year. There's about a $100 million difference in the suggested level of activity in Eastern Europe.

It asks us to increase military aid by about 7 percent. It asks us to enrich further the military portion of the aid bill by taking the remaining $400 million in military loans and converting them to outright grants. It makes reductions in some very useful and very popular programs, like UNICEF. I don't think those reductions will survive longer than you can talk about them. So it is a repetition of the request that was made this past year.

I hear all of you saying that the aid budget is going to require significant changes, as many as we can manage this year, and certainly much more significant ones in the out-years.

INVESTMENT IN EASTERN EUROPE

Let me begin with Eastern Europe. We have an argument going on now about whether or not our assistance ought to be confined largely to private rather than public investments in Eastern Europe.

I think the administration's concern is that we have negotiated on this Eastern European Bank. That is a very large pool of money indeed if we wind up getting stuck into the business of providing assistance for public sector activities. On the other hand, we had witnesses yesterday testifying—and you have indicated this morning, most especially with respect to infrastructure, transportation and communications—that it is necessary for us to participate in that effort.

I understand where you come down on that question (indicating), but where do the other witnesses come down?

Mr. **Colby**. If I may, Mr. Chairman, you are dealing with a country which has a high degree of state ownership in its economy, or has traditionally over the last 40 years. You cannot get rid of that in two weeks.

Certainly it is desirable to spin those off and to privatize them, but it is going to take time. In the meanwhile, you really want the economy to have the momentum that satisfies the people.

The most difficult process in changing from a state run economy to a private run economy is that you immediately get inflation and unemployment. That is the normal reaction.

Now, if we have that, you are going to have very disappointed people who brought about this fantastic revolution in Eastern Europe. Therefore, while certainly we all agree that a privatized economy is much better, I think there is an interim period here.

Dr. **Steinbruner**. If I may comment, I am aware of the argument that the prospect of infrastructure investment, even if we, in principle, accept it looks daunting because of the magnitudes involved. That is certainly true, but it is also true that capital will be rationed in Eastern Europe at whatever level. Accepting that some of it ought to be directed to infrastructure investment does not mean that one is irretrievably committing to paying the full bill.

I think it is very important that we admit the category to our concerns and then struggle with the question of how much we really can provide and how we ought to ration what we can provide, knowing that it is going to be far beneath requirements for the moment.

Mr. OBEY. Did you want to respond?

Mr. FRYE. I was only going to say, Mr. Chairman, that the judgments are very difficult to make from a distance and in general, because each case is so concrete, as far as the needs of the particular countries in Eastern Europe are concerned.

I find this transitional budget from the administration to include some hopeful elements that accommodate the public sector direction that will have to be an element for some period of time.

In particular, I think the notion of joining in the multilateral efforts is clearly evident as a concern within the budget. It is not my place to presume to speak for an administration. But, as a private observer, I note that there remains a substantial food aid component, which may have an important role in this period of consumption requirements building up faster than production capabilities do in Eastern Europe.

So I see some elements here on which to build, and I would at least enter the hope that in the Legislative-Executive bargaining that goes on, there can be a recognition on both sides of the great divide between our branches that all of these elements have a place. The judgment calls that are involved cannot be dictated a priori. They are going to be partly a function of the bargaining between this Committee and others, and those in the administration.

But I don't read the budget, as submitted, as precluding participation in meaningful infrastructure development. I don't think there is an issue of principle here. That is my only point. I think there can be a common ground in our government which will permit us to move out, to seize the opportunity that Dr. Hamburg described.

Mr. OBEY. Okay.

EARMARKING, BASE RIGHTS, AND MILITARY ASSISTANCE

One of the things that frustrates me, frankly, is there has been a strange running in opposite directions of the politics in this country versus the politics in Eastern Europe. Almost simultaneously, it seems to me, we have seen the trivialization of politics in this country at the same time that we have seen it largely ennobled in Eastern Europe. There are tremendous risks taken by people there and elsewhere—everywhere from Nicaragua to Eastern Europe. And yet in this country, we seem to be virtually in a strait-jacket because of Gramm-Rudman. Neither party wants to talk about how we really can break out of the green eyeshade era, as opposed to the policy-decision framework that I would prefer we would be in. And so, we are reduced on this Committee to talk about very small marginal opportunities.

Let me explain one and ask you for your judgment.

Senator Dole indicated to us that we ought to reduce the earmarking for the five big countries—Israel, Egypt, Pakistan, Turkey, and the Philippines. I think the record of this Committee is clear. We have consistently resisted—to a far greater extent than has the Senate—the Congressional hunger for earmarking. I have asked the administration consistently whether they would, in fact, provide less money to Israel and Egypt if they had further flexibilities. They would not provide less money. In the case of the Philippines, we did not earmark specifically at all, and so, the administration has provided whatever it desired to provide for the Philippines. In the case of Pakistan and Turkey, the other two countries involved, we, in fact, provided somewhat less money than the administration requested in its budget. For FMS, we provided about $50 million less than the administration asked. For the Economic Support Fund, we made no earmark at all. And so, when you get passed the theory of the Dole approach, there are no dollars being earmarked.

A second problem is base rights. This Committee, with some exceptions, has felt we should not be providing aid to the base rights countries as assurance for a continued presence of those bases. Instead, we ought to provide it on the basis of need, and not tie to the existance of bases. The administration does not agree with that position. In my judgment, if we do not make some effort to reduce the funding for those base rights countries, we really are going to have very little room in this bill.

There is another issue on the military side of the ledger. The administration is asking us to increase Military Assistance, and, with the exception of some increases in the IFIs, to reduce Development Assistance. We have two choices. We can go to Mr. Murtha and company and say Jack, give us some money out of the Pentagon budget, or we can try to reduce base rights contributions and reduce somewhat the administration's military requests in the budget.

First of all, how do you feel about each of those possibilities? Secondly, if you don't like those, where else would you go?

Mr. COLBY. Well, this gets down to the basic question we raised, Mr. Chairman, that the requirements of the years ahead are not military and strategic. They are social, political, and economic in large part.

Now, if your bill is carrying a good strategic charge, then that charge should be shifted over to the Pentagon budget. If it is a strategic military charge that the taxpayers should pay, then fine. But let it compete in the Pentagon against other Pentagon expenditures.

That is one answer. Therefore, I would agree with your idea of just squeezing down on the military components of the present Foreign Aid Bill.

But I also think that you should be able to get more money.

The administration has protected a whole run of weapon systems that are very, very expensive and are going to get more expensive. The B-2 bomber costs over a half billion dollars apiece. It is just as practical in modern day warfare—and I mean warfare, not the Cold War being over—as horse cavalry to send a manned bomber into the Soviet Union when you can stand offshore and send cruise missiles.

Now this is an absurd expenditure. It should be stopped in its tracks. That money could be made available for the useful kinds of things you have in mind.

I don't see any planning for other kinds of reductions that make all the sense in the world these days. The D-5 missile, there is very little point in a highly accurate, intercontinental submarine missile at this point unless you want a first strike. And we don't.

The SDI we cut to a "mere" $3 billion. Now, come on. You know, $3 billion is a lot of money anywhere but in the Pentagon.

Shouldn't it go down to $500,000 or something of that nature if you are going to have an impact on it?

Now there's some money for Eastern Europe, and for strategic purposes, but spent on the economy and the social needs.

There are a variety of other kinds of cuts that are quite feasible.

Mr. **Obey**. Well, what you are essentially recommending is a redefinition of national security.

Mr. **Colby**. That's right, and national security is how safe are we from attack in Eastern Europe.

Now, at one point I fully supported the whole NATO expenditure and the containment policy. But it is essential to recognize that the ballgame has changed and not just play the old ballgame.

ASSISTANCE TO BASE RIGHTS' COUNTRIES

Mr. **Frye**. Mr. Chairman, may I comment specifically on the one issue that you raised, on which I think there is a lurking consensus that has to be developed?

I think that we saw in some of the conclusions by the House Task Force on Foreign Assistance last year, led by Congressman Hamilton and Congressman Gilman, a pretty good start on rejection of the notion of foreign assistance as rent for bases.

Now, I think that, even though the administration has not yet said it that way, I believe imbedded in what they are doing is, in fact, a pretty good movement in the direction of a similar point of view.

For example, Secretary Baker is very direct in some comments about a certain government's foreign minister, who was beating up on us pretty hard some months ago, and now is complaining, after decisions to reduce bases were taken, about the loss of hard currency. So there are elements at work here that point toward a consensus.

Mr. **Obey**. Well, the administration may be conceptually changing its position. Unfortunately, in my view, the portion of this bill that has grown fastest has been the base rights' component. I can tell you, almost to the exclusion of all other items, that the administration lobbies me on this bill focusing an incredible amount of their energy on obtaining their requests for the base rights' components. They have an obligation under the treaty to do that. However, we have an obligation to recognize other competing needs, too.

Mr. **Frye**. I certainly agree with that.

Mr. **Obey**. We do not get very much encouragement on that.

Mr. **Frye**. You know, part of this is a learning curve. We are partly lagging behind the change in leverage that flows from the change in the world situation.

To put it crassly, the countries that have held us up for larger assistance in exchange for bases—and that is not every partner that we have; that is some particular cases—have operated from the assumption that because we had the Soviets to worry about, we were going to be more generous to them.

Mr. **Obey**. The problem we run into, for example, is the administration has told the press. The press keeps calling me about it, and says why did you guys cut $98 million from the Philippines.

Congress didn't cut a dime from the Philippines. The administration had no earmarked limitations whatsoever for the Philippines. And so, the amount provided for the Philippines this year was a determination on the part of the administration, unfettered by specific Congressional limitation. The Aquino Government is squawking about the fact they "only" got a 62 percent increase this year over last year's funding. As I said on the floor, if that is a loser, I would hate to see a winner.

BUDGET CONSTRAINTS

Mr. **Frye**. Well, you know, our prayers are being answered on so many fronts so fast that we can hardly realize the answers are coming in.

It's sort of the opposite of the lady on the Titanic, who said at the moment of collision when she was sitting at the bar: I know I asked for ice, but this is ridiculous. [General laughter]

We are getting so many good responses that we cannot quite take account of these answers to our prayers. And the period we are entering permits, I think, a fresh approach to the kind of concern you are stating, and an approach that both will persuade the partners with whom we are negotiating that their leverage is altered and the administration that perhaps they should exploit that leverage to reduce assistance levels to them.

Dr. **Steinbruner**. There is a technical thing that you might consider.

In the U.S. Foreign Military Sales program to Egypt, for example, which is one of the big recipients, there is an overhang of past debt that for military sales. It is extremely unlikely they ever will be able to repay these debts. We could choose to cut a deal whereby we forgive the past debt and reduce the immediate allocation, and both sides would be better off. It is not going to get you big amounts of money, but it is something.

Mr. **Obey**. It probably does not get us any money because the way that is counted under the wondrous world of Gramm-Rudman, we get no savings.

Dr. **Steinbruner**. No savings at all from reducing the existing annual allocation?

Mr. **Obey**. If we reduce the receipts to the Treasury, that is counted in the Gramm-Rudman as an expense. And so, we wind up still getting credit from CBO, for instance, with no savings.

Dr. **Steinbruner**. You wouldn't reduce de facto receipts, although the accounting system may claim that it is a reduction. But the Egyptians are not servicing these past debts. They are not actually repaying this debt, and everybody realizes they are not going to be able to.

Anyway, that well may be a problem of accounting devices not giving you the credit. But it does make sense quite apart from that.

Mr. **Obey**. The problem is computer runs are ruling the world these days.

Dr. **Warner**. Let me comment for just a moment.

I think one of the problems that we have here is in response to the enormous change in the security environment and it is, in fact, going to take us some time to sort the new requirements out. It doesn't spare you, obviously, the difficult choices regarding foreign assistance that you must make during this budget round.

But the United States clearly going to recast its overall defense policy. Our forces abroad are going to decline in numbers. I think the overseas basing structure, in turn, will change over time. Secretary Cheney's recent trip to the Far East provides evidence of moves in that direction.

There will be lively arguments with partisans on one side or another about the fate of specific weapon systems and the like. But I think part of the problem we have here is that the recasting of our entire security posture is in very early stages, and it is almost impossible yet to detemine its precise shape and character.

We have no excuse for allowing ourselves, in John Steinbruners metaphore, "to wander on just looking at our feet without looking up and charting a better path."

But I think these are is the kinds of problems that we confront at this transition point. We are going to have to restructure forces and their basing structure, and with that inevitably will come different military arrangements with foreign states. We clearly have global interests and commitments, and those will have to be factored in. It is not simply a question of the decline of the Warsaw Pact threat in Europe. It is, in fact, a global recalculation and reconfiguration of American national security.

Mr. **Obey**. I understand that. The problem I face is, although I did not vote for Gramm-Rudman and got a double hernia trying to beat it—and lost—the fact is we are stuck with new demands from Eastern Europe which will not wait. They do not fit the niceties of the formula of Gramm-Rudman.

And so, the problem is the demand is now for Eastern Europe, for Nicaragua, for Panama. We have had good news and Gramm-Rudman says sorry guys, you can't respond to it. That's the problem. I am amazed by that fact. That is what I meant by the "trivialization of politics," in addition to the wretched things that pass for campaigns these days. I mean that we are stuck.

We have a tremendous amount of good news. It is like having one second before the end of the first half when your fullback breaks to the line. You have 60 yards and he can go all the way. But you say well, there is only one second left on the clock, so I am going to stop.

That is really what Gramm-Rudman does to us.

Our problem is there is no revenue increase outside of what the President suggested in his budget. In my view, we either have a choice to take more money out of the military budget than the

Pentagon is comfortable with on the front end, or else we do not respond to these initiatives because we cannot reinvent the laws of mathematics.

That is where we find ourselves, which is not very much fun.

Mr. Lewis.

Mr. McHugh. Jerry, would you yield just for a second?

Mr. Lewis. Sure.

POLITICAL LEADERSHIP FOR FOREIGN ASSISTANCE

Mr. McHugh. I'm going to have to run. I'm sorry that I cannot stay.

I did want first to congratulate our panel. I think you have each presented wonderful presentations to us today for your respective areas.

I just want to note that I agree with everything that both you and the Chairman have said, especially with respect to Gramm-Rudman.

Obviously we have a larger problem than just the process of Gramm-Rudman. We have a leadership gap—a refusal to accept the need to make some meaningful savings on defense even though the world is changing. Mr. Colby touched on how we could do that, as well as raise some revenue, to meet our national obligations, not only internationally but here at home.

This has been frustrating for some of us for quite a few years and, unfortunately, it seems likely to continue.

So we have a combination of the process problem, an artificial green eyeshade problem that the Chairman talks about regarding Gramm-Rudman, and, perhaps more seriously than that, an inability to take political risk, which I suspect would not be all that much of a risk if we finally came out and told people what we really had to do. But, nonetheless, the timidity here is incredibly significant, both in the White House and in Congress.

So long as we don't deal with that macro budget problem of cutting expenditures in areas like defense, and raise some revenue, we will continue to have a problem in allocating for budget priorities because we cannot increase foreign assistance. This really is implicit in everything you have said, and I agree with you. In order to respond, we need to get, somewhere, additional resources into foreign assistance, for economic development in particular.

But we cannot do it so long as this Gramm-Rudman political timidity problem continues to put pressure on domestic programs. How do we tell people that we are going to spend more money abroad, even though it is in our interest to do so, when housing has been cut 70 percent to 75 percent and we are unable to respond to that problem? And I could go on.

So the lack of political leadership here is the fundamental problem. The Eastern European challenge and opportunity to us is only the most recent example of where our timidity is holding us back.

So I would agree with everything all of you have said. Some of you have been bold. Mr. Frye has gone where angels fear to tread in the Middle East, for example. This is going to be an issue that we have to wrestle with as well.

I wanted to make those brief comments and, most importantly, to thank you for what I think is a tremendous contribution.

I thank my friend, Jerry, for yielding, though I suspect you don't totally agree with what I have just said.

Mr. **Lewis**. Wait a minute. As you are leaving, let me say that that is exactly where I was going to begin.

If there was a message that came through to me from this panel, it was that each of you in different ways were suggesting that it is time for this Committee and others who have similar responsibility to begin to put some real meat on the bones of political risk.

It is risky for me at home to talk about foreign aid and giving dollars away—throwing it down a rat hole. It is risky for me to even suggest to my people that we only give 1.5 percent of our total budget to this subject area. It is even more risky, perhaps, in the House, for us, as our leaders are talking about 302(b) allocations, to suggest that this subject area deserves a higher priority than my dairy farmers in Chino, where the ag budget has tripled, for god sake. It is risky for us to hammer our Chairman and my Ranking Member and say more money ought to go to this subject area.

Frankly, I think the message you are delivering should begin right in this subject committee as well as the Foreign Affairs Committee. So maybe we can talk a lot about that.

I learned yesterday that the Chairman and I have a lot of work to do this year that I think is going to be very positive and refreshing. But that message at least you delivered to me, and I think it is an important message.

DEBT OVERHANG

One of the items that came forth in a different way yesterday relative to increasing assistance was to talk about or recognize the impact of huge debt overhang on Eastern European countries. A lot of that, a very high percentage of that, is official overhang.

It strikes me that it is one thing for us to suggest that we are not getting any revenue from that debt anyway, so why not write it off. It is another thing to consider reduction of that overhang, but also have some conditionality related to it.

How would our panelists respond, for example, if debt overhang is important to reduce and, at the same time, building a cadre that involves the infrastructure for economic development if one of the conditions might be a higher priority for—we've talked about debt/equity swap in the past, but how about a debt for development swap, where some of that overhang is reserved for priorities that involve training, tapping American universities, et cetera?

Should we, as we move strongly in that direction, removing the impact that debt has upon those countries, put some conditions that relate to the kinds of changes that we perceive to be important for that development to sustain itself?

That's the first question, and I don't know who I should ask it of.

Dr. **Steinbruner**. Just a brief comment on that.

Clearly, if there is to be any debt relief, or even any major new aid supplied, there will be some conditionality. That phrase, as traditionally used, has to do with standard macroeconomic principles.

Mr. **Lewis**. Yes.

Dr. **Steinbruner**. If anything, we should have learned that we have to temper that those principles with some sense of their political impact. We are learning almost everywhere that if you overdo economic discipline, you can destabilize a political system and hurt economic performance in doing so.

This is not a very well developed state of the art. Frankly, we just do not know how to impose politically sensitive conditionality. But some of the ideas that David Hamburg was suggesting at least ought to be thought about in that regard, because it does have to do with training, managerial training, scientific training, and that sort of thing. It may indeed be a good idea to sort of make a connection of that sort.

Mr. **Lewis**. Our universities are talking about debt for development. It seems to me that the time might be very appropriate for us to consider that as a part of how we now define this conditionality.

Mr. **Colby**. Well, in many of the World Bank loans, of their operations, they do require a certain cadre building as a part of the whole project that they are creating. It may be engineering, or it may be managerial. But frequently that is part of the project.

So I think the answer to your question is yes. I think we should bring cadre building in as much as we possibly could.

DEBT OVERHANG OF EASTERN EUROPE

Mr. **Lewis**. I might also mention, Mr. Chairman, that about a month ago, I sent a letter to the President that was really trying, in my way, to make your point, Mr. Colby; that is, urging the administration to consider the reality that if we do get this peace dividend, some reasonable piece of that might go to economic contributions that will sustain the peace itself.

We talk about political risk. You and I share the same kind of problem. Chino probably would not like that letter if they actually saw it: I mean, my god, you are suggesting that we spend more.

The administration, nonetheless, during the Reagan years was asking for maybe $1 billion or $1.5 billion more for foreign assistance than we appropriated.

Last year, we actually appropriated about $2 billion less than the administration requested. It is a reflection of the political reality around here.

This is the easy target, even when you face Gramm-Rudman. We happen on this committee to have a bipartisan past nonsupport for Gramm-Rudman. I voted against the turkey as well. But we live with it. That means that we have to take more risk ourselves in-house.

Mr. **Colby**. But if you could, relate it to a weapon system, Mr. Lewis, that this weapon system is going to be cut in half, and a half of that saving is going to be used in foreign assistance, and not the whole thing. We are going to give the taxpayers a break. It is going down, but some of it is being used.

Mr. **Lewis**. I think that point is a very important one.

Mr. **Colby**. You can put it on individual weapon systems.

Mr. **Lewis**. All right. But wait a second. You have implied it a couple of times, but I would like to have the rest of the panel respond.

One of our problems around here is the "Secretary of State syndrome." We don't quite have 435 who want to be the Secretary, but almost that number.

STRATEGIC ARMS

There is a tendency and there will be great cries this year for dramatic reductions in specific weapon systems. And yet, there was discussion about the fact that there is a need to put pressure on reduction, mutual reduction, of strategic arms growth.

Now, if we are negotiating at the table START and otherwise, regarding those items, and the President has in his quiver X and Y, is it advisable for the U.S. Congress, at that very time, to be unilaterally, if you will, disarming, taking arrows out of the quiver? SDI can be argued in many, many ways. But some suggest, even though Reagan denied it, that it might very well be an important bargaining chip.

Is it wise for the Congress to play that role with no sensitivity, almost, regarding what that might do to our negotiations?

Mr. **Colby**. Most of these weapons are not in the quiver of the negotiation. They are not substantially affected by it. They stand or fall on their logic. They really are not very useful in the modern day.

In other words, you can still have D-5s under the START Treaty. I think you ought to go to a non-multi-warhead.

Mr. **Lewis**. Do you say that an SDI would not even fit in that category, or that the B-2 would not fit there?

Mr. **Colby**. Well, an SDI is prohibited under the ABM Treaty which we already have, I mean, to go ahead with it. The question is whether you spend $3 billion or $500 million on the research in the strategic defense. That is not affected by negotiation at all, unless you are talking about breaking the ABM Treaty, and I really think that argument is over.

Dr. **Warner**. Let me respond for a moment on the strategic offensive weapons and START. In order to preserve first strike stability under START at reduced force levels, you need to maintain survivable, effective forces. So some modernization for survivability is probably, in my view, unarguably required. There is a general consensus, for instance, to continue to build Trident submarines to a reasonable level because they are quieter, and the older SSBNs are becoming obsolescent.

Mr. Colby and I clearly disagree on the continued potential role in both strategic nuclear and general purpose areas of large bombers. On the problem of the B-2, we have already spent somewhere between $25 billion and $30 billion. Those costs are, in fact, already spent and sunk, and the real issue is do you terminate the B-2 Program at this point and put nothing more in, or do you spend additional money and field the B-2 in order to recapture that investment in a revolutionary technology—again provided that that technology proves itself, which has not yet been fully demonstrated? Those demonstrations still lie ahead of us.

So, we will need prudent modernization for survivability and, in a sense, on a case-by-case basis we should be challenging the weapon systems of the strategic and general purposes forces: do they fit the new construct for our security policy of the future?

We are not going to disarm, and we should not. We are going to have to have a different military establishment. And that is an argument that your colleagues who specialize on those Committees spend great amounts of time contemplating, and you too have responsibilities when you go to the floor to vote on those issues.

I urge you to look at the difficult program choices one by one. Look at ICBM modernization. From a purely theoretical standpoint, a small, mobile ICBM, the so-called Midgetman, is probably the best in terms of what it can offer you. The problem is it has substantial costs.

So then you face alternative questions. Do you prefer to stay in silos with what you have? Do you prefer perhaps to put the small ICBM in silos? Do you take the MXs out of silos and put them on rails? Each option has an identifiable cost, and comparisons now must be done much more stringently than we were doing them even just a year or two ago.

Mr. **Colby**. Force modernization is a very, very enticing idea. The question is why modernize.

If the purpose of your forces is deterrence, don't you deter now, with the Minuteman? Sure you can make better ones, either single warhead, multiple warhead, or whatever. But do you really need a new one?

Let's go back and take a look at what direction we are going and not just at each step that we are taking.

Dr. **Warner**. Very briefly, the point here is in order to have a successful deterrent, you must be able to threaten the rival with this clear image that if he starts a war, he will be devastated. That means that the force itself must be survivable and able to penetrate what defenses exist.

In the world of ballistic missiles, we should preserve the ABM Treaty to ensure that ballistic missile defenses are kept at a minimum. Air defenses so far are absolutely unconstrained, and those air defenses have made older bombers unable to do their tasks. They even challenge conventional cruise missiles. So it is not just modernization for the love of new weaponry or new toys. It is and should be examined as serving the purpose of retaining the offense-dominant retaliatory stalemate.

Dr. **Steinbruner**. Let me just offer a couple of simple numbers. If the country ever got around to judging how many weapons it actually needs to deliver to accomplish a deterrent mission—it doesn't even attempt to judge that at the moment, but if it did—it would be extremely difficult to imagine that we would actually want to deliver any more than about 2,000 weapons. This means that we have a factor of five or so more than we need to actually deliver to accomplish deterrent missions.

All that says is that there is ample scope for reductions that are perfectly safe.

Another set of numbers is the overall defense budget itself. Speaking in rough terms, the defense budget stands in Fiscal Year 1990 at about $300 billion.

The kind of security environment that we were talking about, particularly if we do go into very elaborate or explicitly developed cooperative security arrangements, will provide better security at lower costs. That is one of its big appeals.

How much lower costs? Well, there is argument about that. But the range of discussion in the professional community now is between $200 billion and $250 billion, in constant 1990 dollars. That is the range of current discussion.

Now, I realize the government is not there yet. But I'm telling you that that is where most of the professional community of the United States is discussing for the 1990s.

So, again, we have ample scope for defense budget reductions that leave us better off. This is going to be a compelling political proposition, if people ever come to understand it.

Mr. LEWIS. Believe me, all of us want to believe that, and that takes us to the $400 billion that Bill Colby was talking about. That, in turn, suggests that a little bit of risk here, in terms of transfer, might be appropriate, timely, et cetera.

Did you have a comment?

Mr. FRYE. Congressman, I just wanted to say on your precise point that, obviously, modernization and diplomatic leverage, the linkage you made, those elements are both elastic concepts. There are lots of different degrees in rates and types of modernization that one can contemplate to maintain adequate diplomatic leverage in this protracted, strategic diplomacy that we have underway.

I think it is entirely reasonable for Congress to say the momentum in the negotiations is in the right direction. We want to sustain it with ongoing programs in the defense area that are potent enough to make clear to our potential adversary that we can run the numbers up and modernize if we have to, if the negotiations go sour.

But look at what ideas are already abroad. Keeping open the option for the single warhead ICBM, for example, does not require us to buy mobility up front, a very expensive part of the program. Harold Brown in just recent days has said let's build that missile, let's open the option toward a rational modernization of strategic deployments over the next decade, but let's start by deploying them more cheaply in silos in the expectation that the overall threat level will be coming down.

Let's look at the Trident program. There are a lot of older missiles, C-4s, as opposed to D-5s, which are around in the force, which are entirely adequate for a deterrent posture for the foreseeable future. One could contemplate deferring, stretching out—not killing the production line, but stretching out—for strategic reasons something like a D-5 production rate.

These are illustrations of ways in which you could keep modernization alive, maintain the diplomatic leverage that you correctly say we should have, but, in the early years, retrieve some significant funding for other contending purposes of the sort you are considering.

Mr. COLBY. I would just like to comment on your question also.

The point is not that you take the bargaining tool away from the administration. I basically disagree with unilateral reductions. I think they create mischief. All they do is create misunderstanding on both sides and both sides get mad at each other because of it.

But if the Congress clearly indicates that it is really going to take a bite in some of these weapon systems and expenditures, the message to the administration is to get going on the negotiations and get the negotiated deal down to what the Congress is now saying is all they are going to accept.

That puts the pressure to negotiate. It does not take the tool away. It pushes them to negotiate.

Mr. LEWIS. Thank you, Mr. Chairman.

David, do I dare suggest shifting gears entirely? This would be a wonderful time to get about three minutes from Dr. Warner regarding the Cuban military capability?

Mr. OBEY. If that is your last three minutes. [General laughter] Bill.

NATIONAL SECURITY AND DEFENSE FUNDING

Mr. LEHMAN. Mr. Chairman, I'm sorry I'm late, but I had to chair another subcommittee.

It is good to see my old friend Bill Colby here.

To me, you know, I hear words like nuclear exchange and survivability, but I think they are mutually contradictory. I don't think they make any sense.

If you really think about survivability of a nuclear exchange, I just don't understand that. I think I am in an insane asylum sometimes when I hear these fellows talk about that.

It is weird. We can barely survive a mean-sized earthquake.

But we talk about what we are going to do, how we have all of these weapons for our national security, and we spend so damn much money on all these weapons programs, we don't have any money when we finally win the peace to help everybody from Argentina and Nicaragua to Poland, Hungary, and Czechoslovakia.

I think we will, somehow or other, have to get off this defense pork barrel kick that we are on—that is mainly what it is—and use this money not only for our infrastructure and other needed things here that we want to preserve, and keep a reasonable type of defense program that will have to be completely looked at, not the 2,000 nuclear weapons, not the B-2 bomber or the Stealth bomber, that have no mission whatsoever. The way I understand the B-2 bomber and the Stealth, they are supposed to take off after the nuclear exchange.

If that's right, what the hell are you going to bomb then—the rubble? Then you will have nobody here to back you up. You have to refuel it going over, refuel it coming back, there is no place to land it when you get back. And you are spending over $35 billion.

Why, if it was a poker game, you would cash in your chips and get the hell out and take your losses. I wish we had that much sense in our defense budget.

I think I've said too much. Dave, I apologize.

Mr. OBEY. Not at all.

Mr. LEHMAN. I'm through.

CUBA'S MILITARY CAPABILITIES

Mr. **Obey**. Jerry, why don't you ask your question and then I will have two or three followup questions to ask before we leave.

Mr. **Lewis**. All right.

Dr. **Warner**. I heard a smattering of it. Let me get the full shot of it.

Mr. **Lewis**. Some people have the audacity to suggest that Castro ought to be shaking in his boots because of the developments in Central America.

What is the military capability from your exposure at Cuba?

Dr. **Warner**. Well, I have not looked specifically at Cuban military capability in some time. Quite simply, I think the Cubans have sufficient military capability to make it very difficult to intervene against them. That is an objective that they have had since they faced such intervention from the United States in the Bay of Pigs in the early 1960s.

Mr. **Lewis**. I guess, really, my interest is if indeed their economy is in difficult straits and they are having the kinds of pressures that are a part of a shrinking world communication and a lot of other things, are they a threat to other countries? What is the likelihood?

Dr. **Warner**. The Cuban threat to other countries has largely been, I think, a playing out of Mr. Castro's ambitions as a world revolutionary. This is to say since the 1960s, he has been a strong proponent of trying to spread his version of communist revolution. He focused internationally with his colleague Che Guevara on that in Latin America, and his efforts in this area have ebbed and flowed. That led to considerable tensions back and forth with the Soviets because Soviet policy at various times was supporting these revolutionary roads to power, and at other times it was pursuing, as it really is today, very substantial engagement with moderate Third World countries, whether in Latin America or in the rest of the world. Thus Cuban revolutionary sponsorship has gone up and down.

Now, the other big surge of Cuban revolutionary activism on the world scene came in the mid-to-late 1970s, when the Cubans, with Soviet support, put tens of thousands of troops into Angola and also into Ethiopia and the Horn of Africa. As a matter of fact, they still have substantial troops in Angola today.

I don't think this involvement is in the interest of the Cuban nation. But in a political system where a single man is the authoritarian leader, Castro has been able to define these efforts as in Cuban security interests.

Now, in Angola, for example, there were complex negotiations a year or so ago with multiple parties involved. The Soviets were helping urge, as the U.S. was as well since we were the midwife of all these negotiations, the winding down of foreign involvement in Angola—South African involvement, and it has to do with national reconciliation between the two Angolan liberation groups that goes back prior to independence.

So, Mr. Castro appears to be attenuating the role of Cuban "legionnaires" in Africa after well over a decade of sustained involvement. He maintains a modern military capability at home. There is controversy very recently about his upgrading his fighter-interceptors from MiG–23 fighters of the early 1970s to new MiG–29 fighters of the mid-1980s and beyond. Cuba does not seem inclined to and would find it very unhealthful, in my view, were it to try to commit direct aggression against any of its neighbors. But Castro continues to promote in one way or another, through assistance, advice, and even military assistance, the cause of what it hopes will be revolutionary overturns of existing governments, particularly in this hemisphere.

DOMESTIC INVESTMENT, FOREIGN AID, AND THE MILITARY BUDGET

Mr. OBEY. Let me just make a comment and ask two final questions.

Mr. Lewis talked about the need to go home and talk about increasing foreign aid, as opposed to money back home. The problems I see with that are simply this.

If you take a look at our own budgets, as a percentage of the Federal budget, the domestic investment portion has declined by 40 percent in this decade. By "investment," I mean what we invest in our children by way of education, in health by way of health research, and in the community by way of infrastructure development. There is a 40 percent reduction in those programs as a percentage of the budget. We are spending on domestic discretionary programs less now, as a percentage of GNP, than we were spending before Lyndon Johnson passed out the "Great Society" program. We were at approximately 4.2 percent of GNP before the "Great Society" started. We went up under the second to the last year of Carter to 5.8 percent. We are now down to about 3.6 percent, as a percentage of GNP. So we have had a really massive reduction in the devotion of resources toward domestic problems.

If you look at it another way, simply at what the dollars buy that we provide for those same domestic investments—and I'm not talking about Social Security or anything for the sainted seniors; I'm talking about investment type programs domestically—we have seen a 30 percent real dollar reduction in those programs over the decade of the 1980s.

This is why the public is not going to stand for financing these foreign aid initiatives, important though they are, through a further squeeze on the domestic portion of the budget. This is why we come down to the simple question of whether we are going to have additional revenues, or whether we are going to take it out of the military budget.

This gets down to the question of how much can we responsibly take out of the military budget this year. My view is I would take any amount that we could get, given the fact that I think these issues are more important in the short-term for our security than any marginal arguments we are going to have on the military side of the ledger.

To me, the question is this. As you said, Mr. Colby, we spent a great deal of money each year to defend our security because of the Soviet military punch, or of the combined Soviet and Warsaw Pact threat. We now have a different equation. The question is, are we going to be able to convince the American public, and the administration in my view that we should have a significant increase to prevent the instability in that part of the world which helped create both World War I and World War II.

In Nicaragua and Central and Latin America, the question is this. If Mrs. Chamorro in fact takes power, we will have had a second chance. These revolutions do not come out of thin air. They come because there are indigenous conditions and finally people say the hell with it, we are not going to take it anymore. In Nicaragua, they they bought into the Sandinistas because they were the only organized game in town as an alternative to Somoza. We delayed in dumping Somoza longer than we should have. That meant that all of the non-Marxist alternatives to Somoza evaporated in that society. So we got stuck with the Sandinistas. We're stuck with economic deprivation all over Central America, and all over Latin America.

Now, much of that is the problem of the governments themselves. I think Argentina and Brazil have been irresponsible. The question is, are we going to make the kind of investments on the economic side in this Hemisphere that will be necessary if we want to build in some good odds that there are not going to be further revolutions in this hemisphere that we do not like? That is a problem we face. That is why I think it is essential to take whatever whack we can get out of the military budget.

I cannot imagine, if we doubled the largest amount that we are talking about today, that it would really have a devastating effect on the military capability. I know that there is a logic to maintaining a number of these weapon systems. If you want a system which makes intellectual sense, it does not make sense to knock some of these items out. But the fact is, we are dealing with what I consider to be at least short-term, theoretical threats to our security, as opposed to the very real threats that we see every day. It is not a theoretical threat to the American working family because their real income has not gone up since 1975, really, except for the very top people in the society. Certainly non-college educated workers have faced that problem. And we are not doing a thing about it, at the Federal level, to attack that problem.

End of my speech.

SOVIET AND EASTERN EUROPE ENVIRONMENTAL COOPERATION

Let me simply ask two very specific questions.

We hear a lot of talk about the possibility for environmental cooperation with the Soviet Union and the need for environmental cooperation. Does anybody on the panel really think that is a real possibility, and are the Soviets really interested in doing something like that? Do they have the capability of facing those problems now? Are they so marginal, given their other problems, that they are not inclined to want to wrestle with that problem?

Dr. HAMBURG. We have done some work on that and supported some activity in that field. I think there are real possibilities. The environmental damage in the Soviet Union is just immense, and in many of the Eastern European countries as well. The whole nature of the command-and-control economy over the years was such that the least possible consideration was given to the side effects of heavy industrialization. The consequences of that neglect have been devastating.

Now, that has made an impact. Indeed, it was possible, even in the Brezhnev era, for a certain amount of organizing to be done at the community level, and to some extent on a regional basis within the Soviet Union, on environmental problems without that being perceived as a political threat. Later it got to be a political threat. So something akin to political groups were able actually to get going on these environmental issues. It appealed to feelings of Russian nationalism and other values. What is happening to our country, our precious assets? Our national treasures are being destroyed and we have to protect them.

So there is that kind of public opinion and national grassroots activity in this field. I think the impact is relatively strong. But the problems are horrendous. One problem is the marginal nuclear technology, such as we saw at Chernobyl. But there are many others.

Now, they are aware of these probelms and are facing them. Their scientific community has put forward some very good people. The current Soviet Minister of the Environment is a very capable individual. They are actively seeking ways to cooperate with us on Northern Hemisphere environmental problems. Much of the world's environmental damage has, in fact, been done in the Northern Hemisphere by the U.S., Europe and the Soviet Union, as George Kennan pointed out a long time ago.

So the intellectual and technical background for serious cooperative efforts is there. There was a prominent event in Moscow this past January in which Gorbachev addressed an environmental forum. The forum was co-sponsored by the new, international foundation in which Sakharov was a major player. Indeed, that foundation has established an international working group on environmental problems.

So I think the possibility for cooperation exists. As you say, Mr. Chairman, they have so many serious problems that the general phenomenon that we find—whether on matters of the environment, arms control, political institutions, or whatever—is that the ablest reform-minded Soviet experts, are spread so thin that it is very hard for them to give focused and sustained attention to anything. Nevertheless, I do believe environmental problems would be a fairly high-priority candidate for cooperative activity.

Dr. WARNER. Let me just make a brief remark.

I completely subscribe to the things that David Hamburg said. There is just no doubt that there are ecological disasters in the Soviet Union that are the product of the Stalinist and post-Stalinist economic policies.

There is clearly a mobilization of opinion. This informal grouping phenomenon that has been turned loose by Gorbachev's glasnost and democratization has begun to couple with real public concern over nuclear testing in Central Asia. We are witnessing an interesting coupling of a sense of environmental disaster and environmental exploitation with strong feelings of national grievance.

There are several examples. The Aral Sea is in the process of drying up and disappearing. The legacy of nuclear testing in Kazakhstan particularly from the more distant past, when there was atmospheric testing, is another example.

One note came from the conference that we attended together. As I remember, Paul Goble, working for Radio Liberty, made a point on air pollution. The Soviets have terrible problems with air pollution because they just do not have the most elementary scrubbers on many industrial plants. He cited an example where one could substantially reduce this in pollution in many tens of cities with what amounts to quite inexpensive types of technology.

The Soviets face serious choices regarding social investment in a circumstance where they find themselves in straits that are every bit as bad, and in many cases quite a bit worse, than we find for ourselves.

Now, whether such untertakings can become cooperative ventures with the United States or with others remains to be seen. It would appear to require a relatively small amount of investment to relieve a very serious problem which, as Mr. Goble noted, has terrible health effects. You most certainly have heard that life expectancy in the Soviet Union over the past several years has been declining. Some of that decline is attributable to problems of infant mortality, which, in turn, are associated with serious air pollution.

CAMBODIA AND THE KHMER ROUGE

Mr. OBEY. Mr. Colby, one last question on Cambodia.

What ought we do, besides continue to drift along allowing the Khmer Rouge to go on there?

Mr. COLBY. This is the spring of elections, Mr. Chairman. We ought to have an election supervised by the U.N. as soon as possible. The great powers ought to insist that an election be held there without waiting for any agreement among the constituted parties.

These are all self-appointed representatives of the Cambodian people. It's time we got a representative of the Cambodian people. We have been diddling now, trying to get these four incompatible parties to work together, and they won't. There is no reason they should.

I think we should never help the Khmer Rouge to put their nose under the tent. Keep them out. Tell them that if they want to run for office, fine. They'll get licked, and that's fine.

Mr. OBEY. So what is the mechanism by which we bring that about?

Mr. COLBY. The five powers, the Security Council to set up an election along the Namibia example. Don't pick and choose about whether you'll try to replace the whole present Cambodian Government. The heck with it. Just go in and have the kind of election we just had in Nicaragua—a wide open election with a lot of international observers to keep it honest. Then you will have a representative government for the Cambodian people, and all the rest of the negotiation can just be shoved to the rear.

Meanwhile, we should stop the fighting.

Mr. OBEY. All right.

Thank you all very much. I appreciate it.

THURSDAY, MARCH 1, 1990.

DEPARTMENT OF STATE

WITNESS

HON. JAMES A. BAKER III, SECRETARY OF STATE

CHAIRMAN'S OPENING STATEMENT

Mr. OBEY. Good morning. Today we will hear from the Secretary of State concerning the administration's fiscal year 1991 request of $15.3 billion in U.S. foreign assistance and export financing. This amount is $810 million in discretionary spending above the amount appropriated last year for nonexport-related items. This year's request represents a 66 percent growth over 1981.

The administration this year is urging once again a reduction in export assistance funding through the Export-Import Bank. You are requesting some minor adjustments from last year's budget request. You are requesting a reduction of $23 million, for instance, in UNICEF, which is one of the most important mercy initiatives in the world aimed at saving children.

Your budget suggests a reduction of 17 percent in U.S. support for the United Nations Environment Program, the agency which has taken a world leadership in trying to stimulate the worldwide attack on the environmental crisis facing us all.

In contrast, the administration recommends an increase of $317 million for military assistance funding. The total request for military assistance represents about a 60 percent growth since 1981, and the administration is recommending further enrichment of military aid programs by converting $410 million in military loans to grants.

The committee also sees the administration planning to make significant amounts of excess military equipment available to third world countries.

Mr. Secretary, I think it is legitimate to say that the Congress is probably going to express a significant amount of skepticism with respect to some of those recommendations, especially the recommendations for increases in military expenditures.

THE U.S. ROLE IN A CHANGING WORLD

Mr. Secretary, Mr. Gorbachev, as you know, has made radical internal changes and amazing external changes in Soviet policies. We are facing a radically different world, but the foreign aid request presented by the administration has changed marginally, if at all. With some marginal exceptions, the administration's foreign assistance request is almost identical to the budget submitted by the administration last year. There is a $100 million difference in aid levels for Eastern Europe which represents in the overall bill a change of less than one-tenth of 1 percent, and some other marginal changes which you have indicated in your own testimony.

In my own judgment, there is something else that has not changed, and that is the condition of American politics. Our presidential campaigns, in my view, have been reduced to little more than atmospherics and sometimes negative attacks on each other.

In Europe we have seen group after group of leaders who have literally risked everything to make a real difference for their people. In this country, though, I think politics has often been trivialized to the same extent it has been ennobled in Eastern Europe. After World War I and II, America emerged in an even stronger position economically than it had been before the wars. Today I think it is safe to say that we emerge from the end of the Cold War in a weaker relative position than we entered.

Until last year people were talking about the Japanese century. Now with the events in Europe they are talking about the European century. Those conversations, I think, are based on the assumption that the nations who will be the movers and shakers will be those who have the resources to project their economic and political power around the world, not to mention military power.

If you look at the world now, Japan and Western Europe have little debt. We have a great deal of debt. Our trade deficit is almost as large as the combined trade surplus for Japan and West Germany.

We have tremendous new opportunities and obligations opening up to us. However, it seems to me that in this "read my lips" Gramm-Rudman era, our policy responses often seem to be limited by bean counters, green eyeshade boys and accountants, especially under the Gramm-Rudman rules, rather than by leaders who are able to respond with visions and determined policies to implement those visions.

We have had numerous calls for an active and expanded American role in the world on the political and economic front, even as our military obligations diminish. However, the accountants seem to be running the world—at least in this town. If America is to continue to be number one in the world, we need to pay at least as much attention to our new opportunities as we pay to our computer runs.

NEW FOREIGN AID PRIORITIES

We have had some suggestions from people such as Senator Dole that the administration make reductions in aid to the five largest U.S. foreign assistance recipients. I have not seen much indication that either the administration or the Congress would choose to significantly cut aid to those countries below the amounts already provided. In fact, as a practical matter, the Congress provided somewhat less aid to those five countries last year than the administration requested in its budget.

In my judgment, that means we have to look elsewhere for significant resources to fund new initiatives and meet new obligations ranging from Panama and Nicaragua to Eastern Europe and beyond. It is clear to me, Mr. Secretary, that those initiatives cannot and should not be funded by further squeezing domestic investments such as education, health, job science and infrastructure. They have already been reduced by almost 40 percent as a percentage of the budget. We have paid a heavy economic price for that, and I do not think the American public will stand for the further erosion of those investment programs.

In my judgment, that means any increased foreign assistance—and there certainly needs to be some—will need to come from reductions in other portions of this bill or reductions in military spending. I hope we can explore with you today where some of those reductions might come from.

Mr. Secretary, this committee stands ready to help you turn a page in history. One page we have already turned together is in Nicaragua. In my judgment, the key turning point came when the Congress negotiated with the Reagan Administration the compromise which enabled or which established the procedure and the timetable for a separate vote on ending military assistance to the contras. That separate vote, which occurred in February of 1988, cut off further military assistance. This had been a precondition for the Sandanistas to sit down with other regional governments to negotiate the cease fire. That step set in motion a series of actions that culminated in this week's stunning election. I think the administration is to be congratulated for moving from a policy of unilateral militarism to a bipartisan policy of regionally applied economic and political pressure.

I can remember meeting with you, Mr. Secretary, in the Speaker's office when a large group of people were putting together the finishing touches on the agreement between the Congress and the Bush Administration. The agreement finally turned American policy from the previous unilateral reliance on the military option to the application of regional pressure led by President Arias and supported by the United States.

I think we can both feel good about that. You, and I, and a number of others took a significant amount of criticism at that time. I think we have the proof today that it was the correct course. It shows what we can accomplish by pursuint policies based on broad consensus, rather than on a narrow base of support, and by the branches of government agreeing on policy and working together to promote it.

Mr. Secretary, we need new policies to match the new world which is unfolding before us. We have opportunities and obligations, in my view, every bit as challenging as exciting, and as demanding as any since 1945. It seems to me we need to play a larger role in Eastern Europe to pursue both our political and economic interests.

We need a fresh approach in El Salvador. We need a new examination of our base rights payments, which since 1981 have been one of the fastest growing portions of this bill. Most of all, it seems to me that we need a recognition that we are in a time of dramatically reduced military threats from our major adversary. The needed response from us, under the circumstances, is not to increase military aid.

Now obviously we have some differences, as I have indicated in my opening statement today. But we also have areas of agreement. For example, I want to make it clear that I support and, I think it is safe to say that many Members of this committee support the administration's efforts to move the peace process forward in the Middle East after almost a year of delaying, neglecting and foot dragging by various parties. I hope we can productively explore that issue and others with you this morning.

The only other request I have before we begin is that I know you are anxious for the Congress to move ahead on the Panamanian supplemental. We are anxious to move ahead, also. Before we are able to, however, we need detailed justification from the administration so that we know how the money is going to be used. We need to have defense funding sources which match the request from the Defense Subcommittee. So far, they have not had very much success in getting that information. We would appreciate your help so that we can proceed as quickly as possible.

We are glad to have you here.

Mr. Edwards.

MR. EDWARDS' OPENING STATEMENT

Mr. EDWARDS. Mr. Chairman, Thank you.

Thank you for being here today, Mr. Secretary. I am going to keep my remarks relatively brief because we are all very interested in hearing what you have to say.

I want to commend you on the really excellent job you are doing. I do not know who could do a better job as Secretary of State for this country. I think you have done an outstanding job first at the White House and the Treasury during the last administration and now as really an outstanding Secretary of State.

Although we may sometimes disagree on aspects of the Administration's foreign policy and on the role of Congress in shaping that policy, I really do believe you are one of the truly outstanding people in public service.

Since you were here last year, there have been a great many rather amazing changes in the world. Freedom is not only sweeping through Eastern Europe and the Soviet Union but through Panama, Nicaragua and other parts of the world as well. Freedom is even beginning to stir in South Africa.

I do not want to talk a lot about the specific foreign aid requests by the administration. World events are moving so rapidly that it is very difficult to predict what levels of aid are necessary for each country. If you were to submit a new request once a week, you probably would still have to be revising it as we went along.

I do think, though, that there are a couple of things we need to take into account. It seems to me that in terms of our foreign aid budget and our foreign policy generally we really are almost tabula rasa. We are starting from scratch because the world that we have today is not like the world we had six months ago. It is nothing at all like the world we had a year ago. I think that requires us to make some fundamental reassessments.

Basically what we have been looking at over recent years has been either containment of the expansion of Communism or under the Reagan Administration, which you served so well, a rollback of Communist expansion. We are still all very anti-Communist. It is just hard to find a Communist to be against.

The other day at a press conference I suggested that perhaps we ought to create an Albanian theme park so people can come see what Communism is like. [Laughter.]

If that is the situation, if that is what we are faced with and if our policies have been based on stopping Communism, the question is what is our policy now. It seems to me that fundamentally it has to be what it should have been all along as a correlary to our anti-Communism, and that is to strengthen democracy, to strengthen democratic institutions around the world. It means maybe we need to put less money into a foreign aid package that sells arms and more of it into things to promote parliamentary systems, the free market and the other elements of a democratic system.

Mr. Secretary, this may surprise you a little bit, although I suggested this also when we had breakfast in your office. Coming from me it may be a little unusual, but I think in the area of foreign aid where you have so much more expertise with your embassies on site and your personnel in the Department that we perhaps in this area ought to be giving the administration a great deal more flexibility than we have.

I would like to see the Congress move away from so much earmarking of foreign aid money, give you broad general parameters, tell you what things we do not want, and within that category let you make those decisions. I would hope we are able to move more in that direction.

In terms of what is happening in Europe and in Panama and in Nicaragua. We cannot be timid. We have to move very boldly to take advantage of the opportunities that these changes give us to strengthen our national security and help make sure that these countries move irrevocably into the free world, that they do not slip back toward communism. That has to be done.

I am constantly reminded as I look at the changes that right now we are seeing the world remade in America's image. The world is beginning to resemble the United States in its commitment to democracy and the free market; but I also know that we live in a democracy which is the finest philosophy of government yet devised. It was devised by the Greeks, and the Greeks today are sort of secondhand watchers. Today they are observers; they are not major players. I think we have to move very boldly in a lot of areas to make sure that we are major players in this world which we have created.

Finally, I want to say to you that I commend the administration and the previous one for its efforts to bring freedom and democracy to Nicaragua.

I was asked at a press conference the other day how I felt when I woke up and found out that Violetta Chamorro had won, and I said I wanted to feel euphoric, but I was too stunned. It is truly one of the great achievements that we have. Whoever gets credit for it—there is enough credit to go around to a lot of people—but it was a great achievement, and it gives people in Nicaragua finally, after a ten-year struggle, the chance to have some hope for peace and democracy.

Finally let me say, Mr. Secretary, that whereas this administration began by saying let us put foreign policy a little bit on hold and do a reassessment, let us figure out where we are, and that was done very well, very efficiently. It is time to do it again because even though one year has passed, the world has changed enough that we need a brand new reassessment.

I am convinced that you are the right man to bring that about because your unique blend of commitment to American ideals and pragmatism in seeing to it that those ideals are advanced makes you the ideal Secretary of State for this particular time in our history, and I am very delighted to have you with us.

MR. BAKER'S OPENING STATEMENT

Secretary **BAKER**. Thank you, Mr. Chairman, and thank you, Congressman Edwards, for those very generous comments.

Before I summarize my written statement which I would ask be included in the record, let me simply say that I am quite confident that there would not have been a bipartisan accord on Nicaragua but for the contributions that both of you made, each of you receiving opposition from elements within your respective parties. And I think that the bipartisan accord helped us at least arrive at the position we find ourselves in today, although, as you pointed out, Congressman Edwards, there are a lot of people that deserve the credit for what happened down there in Nicaragua.

I also have to say that I share the comments that each of you have made about the change that is taking place around the world today. As we see it, our duty is to manage this dynamic change effectively and efficiently, and the budgeting process as it has developed over the years really does not lend itself to that too well. So, perhaps together we can find ways to make up for that shortfall.

The comments that you made, Congressman Edwards, about the Albanian theme park remind me of a story that I heard a year ago, and I would not have felt free to tell it a year ago, but it is a story that was circulating at that time in Eastern Europe about the membership drive that the Communist Party had put on. And the deal was if you recruited one new member, you did not have to go to the meeting. If you recruited two new members, you could resign from the Communist Party. And if you recruited three new members, you could get the record that said you were never a member of the Communist Party. [Laughter.]

That is not a story we tell by way of gloating or anything. It is not a story that was told in the West. It was a story that was being told as far back as at least a year ago in Eastern Europe.

DEMOCRACY AND A NEW AGE

I welcome the opportunity to be here this morning and to discuss our foreign policy priorities and our fiscal '91 budget request. Each of you have taken note of the fact that we are meeting in the aftermath of another triumph for democracy down in Nicaragua. And what you have said with respect to that I think is sufficient.

Let me simply say that we now have the job before us of seeing to it that there is a peaceful transition that is primarily a responsibility, of course, of the Nicaraguan people, and it is a responsibility that I am quite certain that they will fulfill as I testified yesterday before the Senate Budget Committee.

At the same time, the United States can play, I think, a role in that. The important thing is that we not divide up here having come together on a bipartisan policy approach to the issue of Nicaragua. It is very important that we not now divide up here into a political debate about who should do what first in terms of effecting a peaceful transition down there. We ought to all work to make certain that that transition takes place.

Two or three or maybe four weeks ago, Mr. Chairman, I took a trip through Eastern Europe. I went to Czechoslovakia on my way to a ministerial meeting in the Soviet Union, and I noted that in Prague the old Czechoslovak republic is being recreated as a new and vigorous democracy.

In Moscow I noted the fact that the Communist Party plenum which was being conducted at the very time that I arrived led by President Gorbachev had abandoned the guarantee of party primacy for the Communist Party, setting the stage, of course, for the beginnings of possible multi-party politics there.

I noted the fact that in Bulgaria and Rumania there were new and vigilant opposition groups pressuring for free and fair elections, all of which represents the birth pangs of democracy.

We went from the Soviet Union to Ottawa where I worked with my NATO colleagues, the established democracies, to make some progress on arms control and new security arrangements that I think promise us, at last, the prospect of a Europe that is whole and a Europe that is free, including a democratic Germany as a member of the NATO alliance.

And the Chancellor of the Federal Republic's visit here last week, his visit with the President at Camp David, I think reaffirmed the longstanding United States-German partnership which is a partnership of free peoples and reaffirmed that that partnership is going to continue to play a vital role in the future of Europe.

And finally, of course, the democracies of this hemisphere led by our President took a very large step forward at the Cartagena summit in an increasingly united campaign to win the war against drugs.

While all of this was going on as one of you noted—I cannot remember which one now—the welcome news of the release of Nelson Mandela reminded us of the worldwide sweep of a surge toward freedom. And clearly we have a major role in fulfilling the promise of this new age of democracy.

After the old dictatorships are swept away, new democracies have got to be built up, and they have got to be built up in a way that they can be sustained. There are very significant major political, economic and security challenges that have to be overcome, and the message that I took on my trip through Eastern Europe, through the Soviet Union back to Ottawa and home, Mr. Chairman, was the message the President announced from the very first day he took office, and the message generally to these people in these emerging democracies and these reforming countries is that as they travel the road toward democracy and as they face the challenges that they face, they are not going to travel that road alone. The American people and the United States are going to do what we can and what we have within our capabilities to do to assist them.

We are committed not just at the outset of that journey, but we are committed straight through until together we can bring about a new world of peace and freedom.

And this brings me to a brief summary, if I might, Mr. Chairman, of the resources that we think we are going to need for this journey to the new world.

ASSISTANCE INITIATIVES FOR FY 1990 AND FY 1991

With respect to our fiscal 1991 budget request, we will need others in addition thereto because the pace of chance is so rapid, as you yourself have noted in your opening remarks. Many of these things could not have been anticipated last November and December when this budget was put together.

We are requesting, as you know, $20.8 billion in discretionary BA for the international affairs function, 150. That is an increase of almost 9 percent. It is 8.9 percent over our fiscal '90 levels.

For assistance programs under the jurisdiction of this subcommittee we are requesting $14.6 billion in discretionary budget authority which is an increase of about 5.6 percent more than last year.

We see this, Mr. Chairman, as an investment in American leadership. You yourself just made the point about the importance of continued American leadership. Let me simply say that I am not pessimistic about the prospects for continued American leadership in the world. That leadership is wanted. It is desired. It is, in fact, demanded, and I think we continue to be in a position to provide it primarily as a result of the fact that we continue to enjoy a $5 trillion gross national product in this country, which is roughly twice the size of the second largest economy.

Our budget contains five assistance initiatives, Mr. Chairman, in addition to a bare bones core program. First of all, in support of the dramatic changes underway in Eastern Europe which you noted, we seek $300 million to promote democratic institutions, training and technical assistance, and environmental initiatives and to fund transitional economic support.

We have submitted legislation and we look forward to working closely with you on this proposal. Second, we seek $500 million in supplemental fiscal '90 economic support funds for Panama, and I will pick up on your request that we work with you to develop more detail with respect to the exact nature of the spending that we would foresee, with respect to those funds, and with respect to the details regarding the sourcing of those funds. These funds, generally speaking, would underpin economic recovery through support for business credit, public investment, and economic stabilization.

Thirdly, we are requesting $441 million in military, economic and counternarcotics assistance for the Andean countries. This is an initiative that is essential to the President's drug strategy, and after the successful summit at Cartagena, we and our partners look for congressional endorsement of our joint efforts.

Fourth, we are asking $268 million to clear United States arrearages to the multilateral development banks, one component of an effort to clear our arrearages to the United Nations and other international organizations.

Over the next decade we expect the multilateral banks to play a catalytic role in mobilizing financing for developing countries as they undertake growth oriented reform programs.

It is our view, Mr. Chairman, that the United States simply must meet its commitments to these organizations.

And fifth, and finally, we seek $70 million in supplemental fiscal '90 funds to meet urgent refugee admission requirements arising largely from continued liberalization of Soviet immigration policy.

While these initiatives reflect our most urgent challenges, they really should not come and we hope they will not come at the expense of our core programs which have been instrumental in paving the way for 40 years of peace and economic growth under free market principles.

These modest requests, $8.4 billion in security assistance and $6.6 billion in development and humanitarian assistance will meet only our highest priority programs for longstanding friends and valued western institutions.

For additional information, Mr. Chairman, of course I would refer you to my written statement, and I would like to conclude on this note, and we can go to the Q and A portion of the hearing.

CONSTRUCTIVE CONSULTATION

You and Congressman Edwards have both made reference to the fact that in these times of dynamic change we have got to somehow find the ability to be flexible if we are going to manage this change successfully.

We recognize that accountability and sound management are essential to the effective administration of foreign policy and, therefore, I would like to suggest again, as I did yesterday, before the Senate Budget Committee, that we propose a kind of new code of conduct, if you will, on foreign assistance.

We should look to constructive consultation as the primary vehicle for achieving consensus on program objectives rather than looking to earmarking. Let me hasten to add here that I know that this problem of earmarking is not primarily a problem that originates here in this committee, but it is a problem, and it is one we need to find an answer to and one we need to overcome. So I would like to suggest, Mr. Chairman, that together we explore ways to achieve greater flexibility that serves everyone's interest as we deal with these very extraordinary times and as we deal with these changing priorities.

I know, Mr. Chairman, that you have been supportive in the past of the attempt to limit the practice of earmarking. I look forward to working with you and look forward to working with the members of your subcommittee to advance a new kind of executive-legislative relationship on this critical issue.

I would be delighted to respond to your questions.

[The prepared statement of Secretary Baker follows:]

STATEMENT OF

SECRETARY OF STATE JAMES A. BAKER, III

Mr. Chairman, Members of the Subcommittee:

I welcome the opportunity this morning to review with you the Bush Administration's foreign policy priorities and our Fiscal Year 91 budget request for foreign assistance.

Last year, when I testified before this Subcommittee, I indicated that our best guide to today's rapidly changing world was to be found in fundamental American principles -- freedom, democracy, equal rights, respect for human dignity, and fair play. Over the past year, those values and the necessity for American leadership have been much in evidence. And, as I said then and repeat now, there is an equal need for bipartisanship.

The President and I have been pleased to work productively with you, Mr. Chairman, and with the Members of this Subcommittee and others in Congress and we look forward to even greater cooperation on the agenda before us.

We are meeting here in the aftermath of another triumph for democracy. I know you share my gratification that the free and fair Nicaraguan elections mark a critical step toward restoring peace and democracy in that strife-torn country. The President has declared our readiness to support Mrs. Chamorro's new government in her difficult task of national reconstruction and reconciliation. The way is now open for fulfillment of the dream of the Central American peace process -- peace and democracy in all the nations of the region.

The recent success of the elections in Nicaragua makes it all the more urgent that peace return to El Salvador. Our policy is clear: we fully support the Central American peace process and the call of the Central American presidents at San Isidro last December for the FMLN to cease its attacks upon civilians. We expect the FMLN to enter into negotiations with the democratically-elected government of President Cristiani under the U.N.'s good offices. This is the year to end the war in El Salvador. Soviet Foreign Minister Shevardnadze joined with me in Moscow to support the Central American Presidents' call for peace and democracy in El Salvador. We support President Cristiani's courageous efforts to bring to justice those who have abused human rights and to reinitiate a dialogue with the FMLN with the assistance of U.N. Secretary General Perez de Cuellar. And, we support his government's efforts to resist the violent efforts of the FMLN to impose its minority views by force.

In my confirmation testimony last year, I described a world in transition. It was my opinion then and even more so today that basic American values such as freedom, democracy, human dignity and fair play offered us the best foreign policy guide for this rapidly changing world. Over the last year, those values and the necessity for American leadership have been much in evidence. And, as I said then and repeat now, there is an equal need for bipartisanship.

Truly, we are entering into a new age of democracy around the world. I would cite just a few examples from my recent trip abroad.

In Prague, the old Czech and Slovak republic is being recreated as a new and vigorous democracy. In Moscow the Communist Party Plenum, led by President Gorbachev, abandoned the guarantee of party primacy, setting the stage for the beginnings of possible multiparty politics. In Bulgaria and Romania, new and vigilant opposition groups are pressuring for free and fair elections -- the birth pangs of democracy. In Ottawa, I worked with my colleagues in NATO -- the established democracies -- to make progress on arms control and new security arrangements that promise at last a whole and free Europe, including a democratic Germany, as a member of the Atlantic Alliance. And Chancellor Kohl's visit here this past weekend reaffirmed that the longstanding U.S.-German partnership -- a partnership of free peoples -- will continue to play a vital role in the new Europe.

Finally, the democracies of our hemisphere, led by President Bush, took a large step forward at the Cartagena Summit in an increasingly united campaign to win the war against drugs.

While all of this was going on, the welcome news of the release of Nelson Mandela reminded us of the worldwide sweep of the surge toward freedom. The President expressed the good wishes of the American people when he said that new hope had arrived in South Africa. We look forward to President de Klerk's continuing his policy of reshaping the future of his country in cooperation with all South Africans.

There can be no doubt that the United States has a major role in fulfilling the promise of this new age of democracy. As I noted in Prague, there are political, security and economic challenges to be overcome and new internatonal associations to be considered. The message I brought there and elsewhere was the message they all wanted to hear: As you travel the road toward democracy, as you face these challenges, you are not going to travel alone, the American people will be with you. We are committed not just at the outset of the journey but straight through until together we bring about a new world of peace and freedom.

I want to tell you now briefly what I believe we achieved and how it all fits into our larger foreign policy.

First, we reached a major agreement on the process whereby Germany can be unified in peace with security for all. About a month ago, it became clear to us that the pace of German unification had begun to pick up dramatically. East German elections, originally scheduled for May, had been rescheduled for March. The outflow of refugees from the East was continuing.

At the same time, unification could not take place in a political vacuum. After 40 years of division, the two Germanys alone cannot deal with all of the security or external consequences of their coming together. The four World War II occupation powers retain historic rights and concerns. There is also the larger context of the Helsinki Process -- the 35 nations who had agreed upon all-European security principles in 1975.

We therefore needed a consensus to act on this fast moving problem and history was not going to wait. The time was ripe to create an orderly process for German unification which would give due allowance to German freedom of choice, while reassuring the rest of Europe that due regard would be given to external aspects that might affect them. Before going to Moscow, I discussed the idea of such a process with my British, French and German colleagues. After further discussions in Moscow and then in Ottawa, what we call a "two plus four" formula was adopted. This formula calls for the two German states, after the March elections in the GDR, to agree upon a plan of internal unification. At the same time, the Foreign Ministers of the Federal Republic and the German Democratic Republic will meet with those of us from France, the United Kingdom, the United States and the USSR, to discuss external aspects of the establishment of German unity.

As we see it, the two plus four process has many advantages. It establishes the principle that unification starts with self-determination, the free choice of the German people. It makes clear that the Four Powers approve such a choice. The process recognizes that larger legitimate security interests are at stake in unification, and it gives a specific role to the Four Powers, including the Soviet Union, in dealing with those interests. Finally, it contemplates that the issue will be reviewed as part of an overall assessment of political and security questions in the Conference on Security and Cooperation in Europe, the CSCE.

To sum up, we have a proper balance here between the rights of the German people and the security concerns of Germany's neighbors and indeed, of Europe as a whole.

There are, of course, many contentious issues to be settled. The President has made it clear -- most recently last weekend in his meetings with Chancellor Kohl -- that a unified Germany must be a member of NATO. That is the U.S. position, the allied position and the position of Chancellor Kohl and Foreign Minister Genscher. We have also indicated that, in deference to Soviet concerns, we support Foreign Minister Genscher's proposal that NATO's forces not be moved further east.

There are many other difficult matters to be explored and resolved. Nonetheless, we now have a forum whereby the unification of Germany on its most urgent, practical, people-to-people level can go forward with support of the Germans and the Four Powers, as we work together to iron out the appropriate security arrangements.

Second, we made a major breakthrough on conventional arms control in Europe at Ottawa. The Soviets essentially accepted the President's new proposal on force levels of 195,000 for the U.S. and U.S.S.R. in an expanded central region in Europe. In Moscow, the Soviets suggested that we have a common ceiling for all U.S. and Soviet forces of either 195,000 or, counting the 30,000 U.S. forces outside the Central Zone, a total of 225,000. I explained to President Gorbachev and Foreign Minister Shevardnadze why we could not accept the principle of symmetry. As a matter of simple geography, their withdrawals still leave Soviet forces in the European area of the Soviet Union, while ours, once withdrawn, are an ocean away. Even more significantly, as has now become abundantly clear, our forces are stationed in Europe by consent and our allies want them to stay there, while the allies of the Soviet Union want Soviet forces to leave.

In Ottawa, the Soviets agreed to asymmetry between U.S. and Soviet forces, insisting only that the implicit part of the President's proposal, the 30,000 U.S. troops stationed in Europe now outside the Central Zone, should become an explicit limit. The President approved and the result is an overall limit of 195,000 U.S. and Soviet troops on the Central Zone, it being understood that the U.S. troops stationed elsewhere in Europe will not exceed the 30,000 level.

The Soviets have also agreed with our contention that no CSCE summit on Europe security should take place without a CFE agreement. I must add, however, that a CFE agreement still faces some major hurdles, especially concerning aircraft.

On the President's Open Skies proposal, there was also tangible progress. The governments of the twenty three NATO and Warsaw Pact countries welcomed the open skies concept as a useful contribution to openness; arms reduction and arms limitation. Those attending the Ottawa Conference also agreed to some of the basic elements of an open skies regime.

Third, we laid the basis for a new more cooperative relationship with the peoples of Central and Eastern Europe, based on democracy, economic reform, new security arrangements and at their initiative, new regional associations. In a speech at Prague's Charles University, I said that while 1989 was the year of sweeping away the old dictatorships, 1990 should become the year of building new democracies. The United States was prepared to help in this process, which begins with free elections and the building of democratic institutions. I repeated the President's call for agreement by all CSCE members to hold periodic free elections. In addition, we would like to have observers from the CSCE states for each of the free elections promised throughout Eastern and Central Europe.

I made clear throughout my trip, and especially in Bulgaria and Romania, that any backsliding or rear-guard action against democracy would isolate the backsliders from our help. If the countries of this region are to flourish in freedom, then they must create free institutions and free markets responsible above all, to the people. That's what the democratic revolution is all about and that is why we are making our aid contingent on democratic reforms. This "democratic differentiation," as we call it, will not affect our humanitarian aid but will determine the extent to which we offer additional support.

In Prague, I was also able to tell the Czechs of our economic assistance package and of course, to urge upon them reforms leading to a free market economy. Clearly, the new leaders of Czechoslovakia, like those of Hungary and Poland, are also thinking of new ways to cooperate together. Drawing upon our previous experience after World War II in encouraging such cooperation, I expressed to the Czechoslovaks our desire to help their new coordination efforts, as President Havel proposed in Warsaw, in any way that we could. Such efforts may indeed be instrumental in turning this region of Europe from its historic role as the "lands between" into a new and vibrant grouping of its own.

Fourth, we advanced chemical and strategic arms control. A major original purpose of my trip to Moscow was to advance the START Treaty negotiations. Before we left home some questioned whether we would be able to conduct any business given the Communist Party Plenum then underway. So this is a good place for me to say a word about the political atmosphere we found in the Soviet capital. When we arrived, the difficult, even traumatic plenum was just ending. President Gorbachev emerged more determined than ever to double his bets on perestroika. He explained to us why a majority felt that the economic and ethnic trouble now besetting the Soviet Union could only be resolved by radical advances rather than by any turning back. That meant creating a more competitive party system, with the communist monopoly ending and a stronger Presidential system subject to popular will. It meant an effort at more radical economic change. And it also meant new arrangements with the republics, perhaps even negotiated treaties which spelled out rights and responsibilities.

In short, the Soviet leaders were anxious to forge ahead and we were therefore able to make much progress. First, as a joint communique issued in Moscow indicated, the President's proposal for an agreed framework for progress on chemical weapons was accepted by the Soviets. Both countries have decided to conclude a bilateral agreement at the June Summit to destroy the bulk of our stocks. And we are committed to complete multilateral negotiating on a chemical weapons convention that would reduce CW stocks still further over its first eight years and eliminate chemical weapons over the subsequent two years if other CW capable states adhere by that time. This framework is a major step forward. It provides a practical roadmap to reach the goal of eliminating chemical weapons.

Second, we also registered some considerable progress on START. As the President said, we hope to resolve all the major START issues by the time of the June Summit. We resolved the Air Launched Cruise Missile (ALCM) counting issue, in a way that gives us the discount we sought and allows our program to go forward. The issue of non-deployed spare missiles covered by the Treaty was also largely settled and we made progress on telemetry encryption. As for Submarine Launched Cruise Missiles (SLCMs), in a major development, the Soviets accepted our declaratory approach. By that I mean a politically binding statement outside the START Treaty made by each side, declaring the numbers they intend to build over a given period. So some of the toughest START problems have now been resolved, and the Geneva negotiations are on track.

Fifth, and finally, during the Cartagena Summit we and our democratic allies in this hemisphere took a major step forward in the war against drugs. Producer and consumer nations are no longer pointing fingers of blame at each other and arguing who is responsible for the drug problem. Now, we are joining forces to rid our hemisphere of this menace. The President's decision to attend the conference in person, despite threats, and President Barco's determination to press ahead, sent a significant message to the drug cartels: We will resist, we will never give in and in the end, we will win. Now, as the President has put it, we have the first anti-drug cartel. We have a unified strategy, expressed in the Declaration of Cartagena, which coordinates our joint attack on all aspects of the narcotics rackets -- economic, political and security.

To sum it all up, the past month has registered major advances in the President's foreign policy. We are measurably closer today to a Europe whole and free, living in peace and security. The difficult task of building democracy in Central

America and Eastern Europe has begun, with the especially promising elections in Nicaragua leading the way. We have taken important steps toward controlling chemical weapons and a START Treaty. And working with our allies, we are also moving forward in the war against drugs.

These are the up sides, the very encouraging sides. But I would be remiss if I did not also point out the down sides. After 40 years of communism, the democracies struggling to be born or to be reborn in Europe have wrenching tasks ahead. German reunification by its very nature will require patience, fortitude, creativity, and a good will to leave not only the Cold War behind but also the history of conflict which preceded it. We are still a good ways from home on various arms control tasks. Furthermore, I regret to say we still have strong differences with the Soviet Union over some regional conflicts, especially Central America. And of course, we all recognize that the drug war must still be won.

As I told the Senate Foreign Relations Committee one month ago, the old world of dogmatic dictatorships may be on its way out but the new world of secure, prosperous and just democracies is not yet here. It will not arrive automatically. The President has defined our mission very clearly, to consolidate the democratic revolution transforming our world. The message I brought throughout my travels and the message announced by the President from his very first day in office is the message people around the world want to hear: As you travel the road toward democracy, as you face these challenges, you are not going to travel alone, the American people will be with you. We are committed not just at the outset of the journey but stright through until together we bring about a new world of peace and freedom.

Prudent commitment of U.S. resources will be essential to catalyze the promising changes we see on the horizon. In my testimony before the Senate Foreign Relations committee earlier this month, I set out five challenges the United States will face in the 1990's: consolidating democracy, building free markets, helping the peace-makers, protecting the world against transnational dangers, and renewing our alliances. Meeting these challenges effectively will determine whether or not we are successful in advancing fundamental American values and interests across the globe. These are not "inside-the-beltway" issues of interest only to Washington insiders. Rather, they affect the quality of life of every American.

I ask your bipartisan support for the U.S. leadership needed to manage change in a way that protects our basic values and interests. And, I ask you in the Appropriations Committee to provide us the minimum level of resources we need to assure the effectiveness of such leadership.

OVERVIEW OF OUR FUNDING REQUEST

Foreign affairs and national defense together form the backbone of our national security. The President's budget outlines a scenario in which -- assuming present world trends continue -- our fundamental security requirements can be safeguarded in the context of a gradual decline in national defense spending. In this dynamic world environment, however, we must continue to invest judiciously in selected foreign affairs initiatives to ensure that our interests and values are protected into the next decade.

Hence, we view foreign affairs spending, not as a substitute for defense, but as a complement to reinforce the positive developments around the world which can facilitate further reductions in defense spending. We do not propose to spend the "peace dividend" before it actually exists. Rather, we seek to shape a world of reduced tensions where over time our security can be assured at a lower cost.

In the context of a tight budgetary environment, therefore, the Administration is requesting $20.8 billion in discretionary budget authority for International Affairs Budget Function 150 in FY 1991. This represents an increase of $1.7 billion or 8.9% over FY 1990 levels agreed to in the context of last year's Budget Summit. Outlays for FY 1991 are estimated at $18.2 billion, up from $14.6 billion the prior year, a figure artificially depressed by special inflows.

With respect to the accounts assigned to this Subcommittee, Mr. Chairman, we are requesting $14.6 billion in discretionary budget authority for foreign assistance, up by 5.6% from the levels of FY 1990.

These sums are not large in relation to the stakes we have before us, or to the leadership position the American people expect us to play on the world stage. Indeed, our total foreign affairs request represents just 2% of the federal budget, equivalent to about 0.4% of our gross national product. And our levels are down substantially in both real and nominal terms from those over the 1985-87 period.

In most bilateral and multilateral diplomacy, America's ability to shape and influence the world stage has far exceeded our relatively modest budgetary contributions. But our ability to catalyze support for American policy can run aground if we cannot back up our positions with adequate resources of our own.

The returns from our modest foreign affairs spending in the post-War period have been impressive -- forty years of peace, economic growth, and -- most promisingly -- the new wave of democracy we see on the horizon. Let us not cut corners just as our long-standing commitments are paying off.

Our budget request for foreign assistance for FY 1990 and FY 1991 can be divided into two parts:

First, five funding initiatives, designed to respond to some of the most urgent requirements on the world stage,

Secondly, our core foreign assistance programs, essential to maintain the progress which is now bearing fruit in the flourishing of democracy and free markets around the world.

Funding Initiatives

We propose three new assistance funding initiatives for FY 1991, plus two Supplemental FY 1990 initiatives -- one for Panama and one for refugees. All are integral to our ability to protect American values and interests into the next decade.

First, in support of the dramatic changes underway in Eastern Europe, we seek $300 million to promote democratic institutions, training and technical assistance, environmental initiatives, and to fund transitional economic support. Such support includes private sector development, trade and investment programs. On February 7, we submitted legislation to provide assistance to Eastern Europe and Yugoslavia, when the President determines that specific countries are making significant progress toward political pluralism, economic reform, respect for human rights, and a willingness to build a friendly relationship with the U.S. Deputy Secretary Eagleburger has just returned from Eastern Europe and will be meeting with Congress shortly to provide further details.

Second, we seek $500 million in Supplemental FY 1990 funds to support Panama's economic recovery. These funds comprise a portion of the comprehensive $1 billion program announced by the President to dismantle economic sanctions and stimulate a revival of business confidence. We are grateful for the bipartisan Congressional support of the first stage of this recovery plan.

Panama will need supplementary, one-time funding to restore financial stability and underpin a revival of private sector investment activity. Our Economic Support Funds would be used to help Panama regain its economic momentum following several years of mismanagement under Noriega. Together with our friends, including the Japanese, we are organizing a multilateral effort to help Panama normalize its relations with the international financial community, promote business credit, support public investment, and underpin public sector restructuring.

Third, we request $441 million in military, economic and counter-narcotics assistance to support the Andean countries in their struggle against narcotics cultivation and trafficking. This initiative is a central pillar of the President's Drug

Strategy, and addresses a problem ranking high on our list of transnational challenges for the next decade. In the wake of the Cartagena Summit, the Andean leaders look to these resources to support our joint economic, security and political fight against the narcotics trade.

Our request includes $137 million in Foreign Military Financing to bolster the Andean governments in their efforts to maintain effective airlift and military capabilities for the interdiction of drug traffickers. The economic portion of our request -- $214 million -- will assist our friends in developing legitimate alternatives to the narcotics industry and implementing other structural adjustments necessary to sustain economic growth.

Fourth, we ask for your support in authorizing $268 million to clear U.S. arrearages to the multilateral development banks. This is one component of the President's initiative to clear arrears to the United Nations, other international organizations, multilateral development banks, and U.N. peacekeeping activities.

The President feels strongly that a carefully structured arrears initiative is essential to maintaining U.S. leadership in these multilateral organizations. Over the next decade, we expect the World Bank and regional development banks to play critical roles in mobilizing funding to support growth-oriented adjustment in the developing world. To maintain our credibility and influence with these multilateral organizations, the United States must live up to its commitments.

Fifth and finally, we seek $70 million in Supplemental FY 1990 funding for urgent refugee admissions requirements. Last year, I indicated that we might need to revise our FY 1990 refugee funding request, and promised to consult with you on this issue. Primarily as a result of the continued liberalization of Soviet emigration policy, we will admit 27,000 more refugees this year than were provided for in our original request. We look to your support for the resources needed to welcome these refugees.

Core Foreign Assistance Budget

The five funding initiatives I cited above address some of our most urgent challenges as we enter a new decade. But we should not lose sight of the fact that our core foreign assistance programs - which offer basic support for our closest friends, allies, and Western institutions - have played an important part in assuring the stable world environment which has paved the way for those dramatic changes which we are responding to today. Our traditional bilateral and institutional relationships have served the United States and the Western democracies well over the past four decades. The relatively modest investments we are requesting for these basic programs address the key concerns of the next decade - promoting democracy and free markets, supporting the peacemakers, protecting against transnational threats, and invigorating alliances. They are equally important to our ability to ensure that American values and interests continue to be successfully advanced on the world stage.

Security Assistance

For FY 1991, our request for discretionary budget authority for security assistance programs (FMF, ESF, IMET, and peacekeeping) totals $8.5 billion. That marks a modest 4.4% increase over the $8.1 billion appropriated by Congress in each of the past three fiscal years. Our FY 1991 request, however, is less than amounts provided in FY 1985 through FY 1987.

In our single Foreign Military Financing account (FMF), we are requesting $5.02 billion in budget authority for all-grant military assistance programs, compared with the $4.83 billion appropriated in FY 1990. For our small but important International Military Education and Training programs (IMET), our request is for $50.5 million, up from the $47.2 million appropriated for the current year. In Economic Support Funds (ESF), our request is for $3.36 billion in grants, compared with $3.18 billion provided in the current fiscal year. Only our highest priority programs can be met at these request levels.

Our security assistance resources remain essential in complementing our diplomatic initiatives for promoting peace in some of the world's most troubled regions.

Nowhere have our diplomatic efforts been more intensive than in the pursuit of a negotiated solution to the Arab-Israeli conflict. Over the past year, we have sought to create a process that would break the decades-old confrontation between Israelis and Palestinians, and then broaden the effort into a lasting peace between Israel and the entire Arab world. And we have had results. Working closely with both Israel and Egypt, we have hammered out a framework for an Israeli-Palestinian dialogue in Cairo to discuss elections for Palestinians on the West Bank and Gaza. Elections offer a practical step that could launch the kind of negotiating process that could lead to a comprehensive peace -- one based on U.N. Security Resolutions 242 and 338, security for Israel and all states in the region, and the fulfillment of the legitimate political rights of the Palestinian people. We are now working intensively on the practical details of getting this dialogue launched. If the parties are prepared to approach this process in a practical and broadminded way, we can make progress.

To help the peacemakers broaden and strengthen their vital and ongoing efforts, we are again requesting $5.1 billion in combined security assistance for the two Middle East peace partners. That represents about 61% of our total security assistance request. These funds meet military modernization requirements and contribute to economic stability and development objectives.

The United States and Pakistan have enjoyed close bilateral ties for more than forty years. For FY 1991, we are requesting $573 million in total bilateral assistance for FY 1991, down slightly from the $588 million provided in FY 1990. This funding reflects the contintuing importance we place on this relationship, and on the key role Pakistan continues to play in supporting the Afghan people in their struggle for self-determination. Our funding supports Pakistan's return to democracy, encourages economic development, assists military modernization, and more generally promotes regional stability.

NATO is critical to our quest for securing peace and democracy in Europe. As the President recently stated in Brussels, the ending of the Cold War does not mean an end to the most successful alliance in modern history. We foresee NATO's vital military mission being complemented by a number of additional activities which build on its strength in protecting Western security interests. These include conventional force reductions, verification, and collaboration against threats to common security posed by new lethal technology and volatile regional conflicts.

For our NATO allies with whom we enjoy military base agreements -- Portugal, Greece, and Turkey -- we are requesting a combined total of $1.1 billion in military and economic assistance, or 13% of our total security assistance request. This compares with $992 million provided in FY 1990. Greece, Turkey and Portugal are vital to NATO's Southern Tier. As NATO develops new missions over the next decade, we will need to tailor our programs to meet changing requirements. It will remain critical, however, to support host government forces as a complement to our continued access to important facilities, including the Lajes Air Base in the Azores and military and intelligence assets in Greece and Turkey.

We fully support the Esquipulas, Tesoro Beach, and Tela accords as a lasting framework for peace in Central America. Uniting all these accords is a fundamental commitment to democracy and the democratic process. We continue to work with other nations to translate the promises in those agreements into a permanent reality -- whether through El Salvador's five elections since 1982, last Sunday's election in Nicaragua, or the Panamanian election last May that exposed Noriega's corruption to the entire world. We seek the support of all governments for peace and the democratic process in Central America.

To consolidate democracy and support economic development in Central America, we are requesting $739 million in total assistance for the Central American democracies. This compares with $655 million provided in FY 1990. As in prior years, over four-fifths of our request supports economic assistance, which is vitally needed to bolster living standards and promote market-oriented growth strategies, to create a climate for the expansion of regional peace.

To bolster another fragile democracy -- the Philippines -- we are requesting $450 million in total bilateral assistance, plus a second installment of $200 million for the Multilateral Assistance Initiative. This compares with $341 million in bilateral assistance and $160 million for MAI in FY 1990. President Aquino needs our help to implement economic and military reforms necessary to broaden the foundations of her democratic government's stability. Discussions also begin shortly on renewing our base agreements with the Philippines. We hope to achieve agreement on continued use of these valuable facilities.

The key interests above -- together with the security assistance component of our narcotics initiative -- absorb 94% of our worldwide security assistance request. Budgetary restrictions leave us with only $511 million to meet vital security interests in Africa, the Middle East, the Caribbean, Thailand, and elsewhere.

We must face together the prospect of managing tight international affairs budgets for at least the next several years. When resources get tight, let us agree on vehicles to ensure that our less visible but highly essential security interests do not get shortchanged in the process. Let us together explore ways to achieve greater flexibility to respond to changing circumstances.

We would like to work together to avoid the difficult decisions the Administration was obliged to make in FY 1990 in the distribution of security assistance resources. In FY 1990, some 82 percent of our Economic Support Funds and 92 percent of our Foreign Military Sales financing were earmarked for specific country or regional programs. Because overall assistance levels were subsequently cut, we were unable to meet our broad foreign policy requirements with the residual which remained once the earmarks had been satisfied.

In ESF, we were left with some $570 million in unearmarked funds, which had to be stretched to meet some $950 million in justified program needs. In FMS, we had about $396 million to meet $659 million in program requirements. That gave us about 60 cents on the dollar to meet the needs of unearmarked programs across the board. The tough choices on how to distribute the shortfalls have some real foreign policy effects:

-- In Central America, where the economic costs of regional instability have been compounded by uncertainty in key export markets, especially for coffee, our level of Economic Support assistance to the four democracies fell by nearly 30 percent compared to FY 1989 levels.

-- In the Philippines, where much emphasis has been placed on meeting a commitment President Reagan made to the Aquino Government in 1988, we fell short by $96 million, more than a quarter of our combined ESF/FMS pledge.

-- In NATO, which will be vitally important in guaranteeing the security of a newly united Europe, we were unable to meet the needs of two critical friends. Our combined ESF/FMS aid to Portugal fell nearly 30 percent below our request, while our economic aid to Turkey fell 75 percent below our request.

-- In Africa and the Caribbean, Economic Support Fund assistance was virtually unavailable to support the important security and anti-drug efforts of long-standing friends including Kenya, Jamaica and the Eastern Caribbean nations.

International Development and Humanitarian Assistance

To meet urgent human needs around the world and foster greater reliance on market forces, international development and humanitarian assistance will continue to play an important role. The U.S. remains the world leader in this field -- through our direct provision of bilateral assistance, the emergency humanitarian aid we extend in crisis situations, and through the leadership position we take in refugee programs and international financial institutions. Indeed, it is largely through U.S. leadership that the world assistance community has embraced such important humanitarian concerns as first asylum for refugees. And it is greatly due to our leadership that the community continues to move away from traditional state-dominated development strategies.

For FY 1991, we are requesting $6.6 billion in budget authority for international development and humanitarian assistance, up from $6.1 billion actually appropriated for the current year. This increase will support our new Eastern European initiative, and enable us to clear U.S. arrearages to the multilateral development banks.

For the multilateral development banks, we are requesting $1.74 billion in budget authority, up from $1.47 billion in FY 1990. This increase will enable us to clear past arrearages to the World Bank and the Asian Development Bank. Included in our request is $1.06 billion for the annual U.S. share in the ninth replenishment of the International Development Association. This soft-loan window provides concessional World Bank financing to the poorest countries. Recognizing the need for shared responsibilities, we have agreed to contribute 21.6% of this IDA replenishment, down from our 25% share of the previous exercise. Up to half the IDA funds will be slated for Sub-Saharan Africa's most urgent development and economic restructuring requirements.

For our bilateral development assistance programs -- managed by the Agency for International Development -- we are requesting $2.89 billion in FY 1991 budget authority. This provides funding for the following programs:

-- $1.23 billion for the development assistance program, providing for basic needs in the areas of agriculture, population, health, energy, environment and education.

-- $561 million for the Development Fund for Africa.

-- $500 million for the Special Assistance initiatives for the Philippines ($200 million) and Eastern Europe ($300 million) that were described above.

-- $145 million for several smaller A.I.D. programs which respond to a variety of special needs -- including humanitarian disaster assistance, support for American Schools and Hospitals Abroad, and overseas housing programs.

Given the shortage of security assistance funds, multilateral and bilateral development assistance programs will continue to be our primary vehicles for promoting economic growth along free market principles in the countries of Africa. Our bilateral Development Fund for Africa is targeting such assistance to countries willing to undertake adjustment efforts to lay the basis for sustained growth. Currently, 28 African countries are undertaking formal structural adjustment efforts in close coordination with the IMF and World Bank.

Largely through assistance and admissions efforts, the United States continues to play a preeminent role in easing the plight of the world's refugees. We are making significant progress:

-- We improved our assistance to Soviet refugees by shifting our processing activities from Rome and Vienna to Moscow.

-- We are working closely with Congress on special immigration legislation to supplement our refugee programs.

-- We successfully negotiated an agreement with Vietnam to allow reeducation center detainees to resettle in the United States. Last month, the first 750 former detainees and their family members departed Vietnam under this program.

-- We are working hard in multilateral channels to preserve the principle of first asylum for Vietnamese boat people, and to make a success of the the voluntary repatriation program from Hong Kong.

For FY 1991, we are requesting $476 million in budget authority for refugee activities. This compares with $438 million in total FY 1990 resources, including the supplemental funding request described above. These funds will support the admission of 95,000 refugees and 15,000 Amerasian immigrants -- the same number as the current year -- and enable us to assist the immediate needs of millions of additional refugees and displaced persons worldwide.

Other important components of our international development assistance request include:

-- $898 million in budget authority for PL-480 food aid, to support a $1.5 billion program level.

-- $181 million for Peace Corps operating expenses.

-- $225 million for voluntary contributions to international organizations including the U.N. Development Program ($109 million) and UNICEF ($50 million).

For international narcotics control assistance programs under the management of the State Department, we are requesting a total of $150 million in FY 1991, up from $113 million in the current fiscal year. Nearly all of this increase will be devoted to significantly expanding our coca control efforts in the Andes, with Latin American country programs increasing from $57 million to $87 million. The equipment and training we provide are essential to support interdiction and law enforcement operations against the major trafficking organizations.

Stretching the Assistance Dollar

The Administration is utilizing a wide variety of tools to promote an adaptive climate for world economic growth, to ensure that our assistance resources are appropriately leveraged to deliver maximum impact. Over the past year, we and our friends have worked together on a number of programs to lay the basis for stainable growth in the developing world:

-- Our bilateral Development Assistance programs worldwide are increasingly targeted to those countries willing to pursue growth-oriented structural adjustment programs.

-- Our assistance programs for Eastern Europe are largely devoted to simulating private sector development, through the use of Enterprise Funds designed to catalyze entrepreneurial skills. We are working to ensure that a future development bank for Eastern Europe carries a similar orientation toward the private sector.

-- Our own dynamic economic expansion -- into its eighth year of growth -- has provided mutual trade opportunities for U.S. exporters and those from the developing world.

-- Our commitment to an open world investment regime is attracting additional infusions of private capital to equity markets in developing countries.

-- Our strengthened debt strategy now incorporates debt and debt service reduction options. These provide a more solid basis for growth to countries undertaking economic reform programs. Mexico, Costa Rica and the Philippines already have taken advantage of these options. We expect a number of other countries to follow suit this year.

-- Our commitment to support strong, adequately funded multilateral economic institutions helps foster market-oriented structural changes in the developing world. The International Monetary Fund and the World Bank will shoulder additional responsibilities as Eastern European countries seek assistance in adapting to market mechanisms. Latin American countries with structural economic problems will solicit advice from these institutions on the stabilization programs essential to the preservation of their political stability.

-- Our commitment to a successful completion of the Uruguay Round of GATT trade negotiations in December 1990 is vital to ensure the continued expansion of trade and economic growth in the decade and century ahead. We are tackling head on a series of tough issues in Geneva -- bringing open trading rules and discipline to new areas such as services, intellectual property rights, investment-related trade measures and world agricultural production. The GATT talks remain of the highest priority to us. We are working hard with our trading partners -- developed and developing -- to ensure a strong set of agreements that benefit all nations.

-- On a bilateral basis, we are deepening trade relations with our closest neighbors and friends -- Canada and Mexico -- to jointly address some of the major challenges of the next decade. In Mexico, we are working in close partnership with President Salinas to broaden our mutual agenda. Through our Framework Agreement on Trade and Investment, we continue to encourage Mexico to deepen the extensive liberalization of its trade and investment policies now underway.

-- The President has announced a trade initiative for the Andean Region to promote economic growth by encouraging the expansion of legitimate trade opportunities.

-- We are on the way to establishing a new regional grouping in the Pacific Rim, which can help identify and overcome barriers to more efficient flows of trade, capital, and technology, thereby enhancing world economic growth.

Over the past year, the United States has pursued an active agenda to ensure that the fruits of an open world trading an economic system accrue to those countries which are ready to participate on a competitive basis. We will continue to build on America's commitment to private enterprise, individual initiative, and a pioneering spirit to foster market-led growth in the developing world.

CONCLUSION

As the last six months have clearly demonstrated, we are approaching a new age of democracy. Free elections have transformed the globe, from Nicaragua and Panama to Poland and -- in the very near future -- the rest of Eastern Europe. The primary responsibility will be in the hands of the new leadership of those countries -- to craft political and economic structures responsive to the will of the people. But they will also need help to support democratic structures, introduce free markets into controlled economic structures, or simply live in peace with their neighbors. Many of our traditional allies face similar if less dramatic challenges.

Our response to these dramatic events will determine whether we are prepared to reach out and meet the challenges of the next decade. This Administration believes that American values and interests demand that we respond positively to these challenges. The budget request we have put before you is essential to meeting that task.

Let me conclude on this note. In today's dynamic world, we must be flexible if we are to manage change successfully. We in the Executive Branch recognize that accountability and sound management are essential to the effective administration of foreign policy. I would therefore propose a kind of new code of conduct on foreign assistance. We should look to constructive consultation as the primary vehicle for achieving consensus on program objectives. Let us explore together ways to achieve greater flexibilty that serve everyone's interest, as we deal with these extraordinary times and changing priorities.

I know that you have been supportive, Mr. Chairman, of the attempt to limit the practice of earmarking, and I look forward to working with you and the members of your subcommittee to develop a new kind of Executive/Legislative relationship on this critical issue.

Mr. **Obey**. Thank you, Mr. Secretary. Before I get to my questions, let me simply make two points in response.

EAR-MARKING AND MILITARY ASSISTANCE

On the question of ear-marking, I agree with you. I certainly do not believe that the Congress ought to simply provide carte blanche to the administration. An interesting fact in history is that if you go back to all of the budgets presented by all of the presidents back to 1946, you will find that no Congress has ever changed any president's budget by more than 2 percent. So Congress often deals in the margins. I feel strongly that Congress as an institution needs to protect the power of the purse. However, I do not think in the process they need to tie down every last cent and reduce flexibility to the degree they have.

I think Mr. Edwards will certainly verify that in conference last year, he and I were trying to resist additional Senate ear-marks. To the best of my recollection, we did not receive the support of a single senator from either party. I would like to work with you to figure out ways we could resist the add-ons that always come from the Senate and to minimize the ear-markings which we have in this House as well.

Secretary **Baker**. We would very much welcome that, and if I might just add there, Mr. Chairman, that we are making it very clear from day one during the course of this budget cycle that we understand the political situation with respect to ear-marks.

We think we can count votes just as well as people up here can count them, but we are making it very clear that we are willing to stand up and be counted on the issue of total elimination of ear-marks.

We are willing to stand up and be counted on the issue of shaving ear-marks provided it is done in a nondiscriminatory manner across the board, and this is not directed at any particular country or countries, and we are willing to explore the question of creation of maybe a discretionary fund of some kind, or enhancement of the foreign assistance budget in some way, if that is possible.

I just want to make the point that because we are obligated to put numbers by accounts when we send a budget up, I do not want anybody to misunderstand us. We are quite willing to stand up and be counted on the issue of total elimination of ear-marks, or shaving of ear-marks.

Mr. **Obey**. All right. I thank you, Mr. Secretary.

The only other point I will make in response to your statement is that if I were to single out my single biggest disappointment in the administration's request, it is that in a year when we have seen the Warsaw Pact virtually crumble; in a year when certainly the military threat to the United States and our allies is immensely diminished; the administration's budget is simply a replication of last year's request—it continues to ask for an increase in military aid and a further conversion of the few remaining military loans to outright grants. In my judgment, this is exactly the wrong way to go given the changing nature of the threat. There is no need to dwell on that, but I am sure we will have plenty of arguments about it during the year. I would like to simply turn to some specific questions.

In the Middle East, Mr. Secretary——

Secretary BAKER. Could I just briefly respond to that point?

Mr OBEY. Sure.

Secretary BAKER. The changing political environment, as we have noted before, has been a matter of rapid change, and much of this change—or a lot of this change—has taken place since this budget began to be prepared back in November.

The wall came down on the 9th of November. A lot has happened since then. Panama has happened, Nicaragua has happened, Bulgaria, Romania—in fact, the GDR, a whole host of other things, and all I am suggesting, Mr. Chairman, is that the changes that we are seeing do not immediately translate into parallel changes in the need to help our friends and allies. There are still regional threats out there that are not affected by the major geopolitical changes that we think have to be addressed.

Mr. OBEY. Okay, well why do we not get to those.

THE MIDDLE EAST

Mr. Secretary, in your judgment, can we afford to reduce the appropriation to the Middle East below the amounts requested by the administration in the budget this year?

Secretary BAKER. Well, that will depend, as I mentioned earlier, on whether or not we do it in a nondiscriminatory manner. I testified yesterday to the fact that there is not a significant lessening of the threat to peace in the Middle East. I do not think there is. At the same time, we must find a way to respond to the remarkable changes taking place in Eastern Europe, to the changes taking place in Panama, to the changes taking place in Nicaragua.

Therefore, if the Congress were willing to eliminate all earmarks, we would come up with a formulation that we think would be satisfactory in the light of the threats across the board, or we would support a shaving of ear-marks provided it was done across the board.

Mr. OBEY. Well, I do not think you are going to see the Congress just give up its responsibility to make judgments on its own. The Constitution requires we make some of those judgments.

Let me put my question more specifically. Would the Administration have any objection if, in our fashioning the congressional response to the Administration's budget, we specifically make reductions in the Administration's budgeted requests for the Middle East?

Secretary BAKER. It depends upon how you do it, Mr. Chairman. It depends upon where you would want to put the money that was generated from those reductions, and it would depend upon whether you did it in a manner that was fair and across the board and not directed at a country or countries, or a particular region.

Mr. OBEY. So you are open to potential reductions in the Middle East budget?

Secretary BAKER. It depends upon how it is accomplished. We would be happy to talk to you about the best way in which we could address the dynamic change that is taking place in Eastern

Europe, in Panama and in Nicaragua and other areas within the context of the limited pie that is available.

If we are not going to enhance that pie, and we may well not be able to do that, then it is far better, in our view, that we not be presented with a situation where 92 percent of our FMS and 82 percent of our ESF is ear-marked, and we then have to give short shrift or zero to countries, small countries in the Caribbean that are cooperating with us in the fight against narcotics, to deal with the emerging democracies in Panama and Nicaragua and so forth.

REDUCING AID TO SPECIFIC COUNTRIES

Mr. OBEY. Could we afford, in your judgment, to make reductions in aid to Pakistan?

Secretary BAKER. I would give you the same answer to that as I would to the other, Mr. Chairman.

I think it is almost criminal that we have a situation with a small country like Jamaica that we provided $25 million in economic support funds for last year. They get a new leadership down there who is very pro-Socialist and pro-Cuba the last time he was in office. Now he is very pro-freedom and democracy and wants to help us in the fight against drugs, and our reward for him is to zero him out.

Mr. OBEY. Well, we are talking about this year's budget. What have you provided for Jamaica this year?

Secretary BAKER. I would have to look at that, but it is probably not a whole heck of a lot. We may have come up here.

Mr. OBEY. Are you suggesting we ought to cut Panama further and increase funds for Jamaica above the level that the administration suggested?

Secretary BAKER. No, I am not suggesting that. What I am suggesting is that we ought not to be hide-bound by what has been done over the course of the past ten years, and that the Executive Branch and the Legislative Branch should cooperate in a way that will permit us to address these changing foreign policy priorities in a manner that is in the national interest of the United States.

Mr. OBEY. Well then, let me get to one area where I think we ought to be making substantial reductions. On page 24 of your statement you say that, as NATO develops new missions over the next decade, we will need to tailor our programs to meet changing requirements. I guess my question to you is—why not now?

Portugal, Greece and Turkey receive $1.1 billion in your budget request—13 percent of your request this year. It seems to me that certainly given the destruction of the Warsaw Pact, we ought not to continue to pour money into Western Europe for bases. These buses ought to be recognized as being in the interest of the recipient countries every bit as much as they are in the interest of the United States.

I find two things ironic, for instance, in the case of the Philippines. Number one, the press has been told that the Congress made cuts of $98 million in the budget for the Philippines. As a practical matter, the Congress did not cut one dime in the administration's authority for spending in the Philippines. The administration made the reductions that were made, and the Philippines still got a 62 percent increase over last year. That is not bad.

So my question is simply, especially with respect to Europe, would the administration be willing to consider substantial reductions in assistance levels to Portugal, Greece and Turkey?

Secretary **Baker**. Well, it depends on the context. If you are asking me that in a vacuum, obviously the answer is no. We have sent a budget up here. But, Mr. Chairman, there is a lot of change going on. We have just notified some of those countries that we are going to close some bases in those countries, and it will not come out of this budget, but coming out of another budget, there will be some diminution.

Mr. **Obey**. But Mr. Secretary, the cost of the new base we are building in Italy is going to cost us more this year than we are going to save on the reduction of all of the other base cuts that you are recommending in your budget.

Secretary **Baker**. That may be, but I hope we are not here debating the defense budget.

Mr. **Obey**. No. I hope we are not debating. I hope we are exploring the possibility of making some real cuts in this area. Alton Fry, who is Vice President of the Council on Foreign Relations, told us yesterday Cold War hostilities have been the cholesterol of foreign policy. They have clogged our brains and hardened our categories. [Laughter.]

It seems to me that with respect to European base rights, that is certainly the case.

Let me ask you two other questions on the Middle East before I pass the questioning to other members of the Committee. I do apologize. I am going to have to leave here sometime shortly after 11:00, because I have a duty to attend to on the floor. I will ask Mr. McHugh to take over the hearing at that time and I may or may not be back, given what happens.

ISRAEL HOUSING GUARANTEES

On the Middle East, as you know the Senate has introduced a bill to deal with the issue of housing guarantees to try to facilitate the movement, as fast as possible, of Soviet refugees out of the Soviet Union to wherever they want to go—including Israel.

How does the Administration feel about the bill that has been introduced in the Senate? Would you support a congressional effort to provide those housing guarantees?

Secretary **Baker**. Mr. Chairman, we are reviewing that bill. We have said we see fungibility as a problem here that has to be considered and looked at.

I think, without giving you a formal Administration position but suggesting that within the Administration there is probably support for the idea, that if there was some assurance, if the Government of Israel perhaps could provide some assurances that it would not be engaging in any new or additional settlement activity in the territories, it is entirely possible that the Administration might then be able to support legislation such as this. But we would want those assurances.

Mr. OBEY. Well, let me say frankly, as you know, we have been told on two occasions by members of the Israeli Government that they do not feel they can give those flat-out assurances. Although they also assure us that very, very few—probably less than 1 percent of the refugees—will be going, or will in fact be settling on the West Bank and that the Government itself is making no effort to promote settlement on the West Bank.

Let me ask you this. I hear some concern expressed about the Senate bill. We have a different problem in the House, let me explain, because the Senate does not have the limitation the House has on credit ceilings under Gramm-Rudman with the accountant's games.

In order to avoid a point of order problem, any legislation that we would introduce to avoid the necessity for budget waiver would have to give the Administration the authority to provide those guarantees after October 1, so that it fell into the next fiscal year, and would not be constrained to the limits under Gramm-Rudman. Since there would be some time that would elapse between now and that point, how would the Administration feel about a delay like that?

Secretary BAKER. I think we would probably prefer that the authority be given to begin after October 1, but it would not change our view with respect to assurances on the creation of additional settlements or expansion of existing settlements, because our policy on that, Mr. Chairman, as I think you know, is of quite long standing. It is a policy that has been embraced by the Administrations of both parties in this country.

We do not think the creation of additional settlements are conducive to the peace process, and in fact we see them as an obstacle to peace, and we have made our views quite clear to the Government of Israel.

Money, after all, is fungible, so when you provide housing guarantees you have no assurance whatsoever that housing guarantees provided will not simply supplant other money that is then used to support settlements in the occupied territories.

Mr. OBEY. Mr. Secretary, I hear what you are saying. Let me say that I think my past record has demonstrated that I agree with your stated concern about the inadvisability of additional settlements on the West Bank. I have held that position for well over 15 years.

I, at the same time, think it is very important, as I am sure you do, to respond to the needs of refugees. I think it is important that the Congress and the Administration work as closely as possible on this so that there is no division in American opinion on the subject, and at the same time respond to those issues.

So I will try to work further with you to see if there is some way we can deal with this problem to accomplish what I know this committee would like to accomplish and what I think you would like to accomplish.

Secretary BAKER. We would like to and we do strongly support freer immigration, particularly by Soviet Jews. We have just been making that case in Moscow three or four weeks ago. We would like very much to see the El Al/Aeroflot Air Line agreement implemented, re-established or implemented.

We encourage that every opportunity we get, but when you talk about furnishing guarantees to build housing, I do not think it is unreasonable for us, since it is the policy of the United States, bipartisan policy of the United States, to ask for some assurances that those funds will not be used to create new settlements or expand old settlements in the occupied territory.

Mr. OBEY. Well, I understand your concern. I hope there is some way that we can work out this problem so that we can, without turning ourselves into pretzels because of the budget axe, still deliver on the need to provide that housing, if at all possible.

EL SALVADOR

Just one last point on Salvador, and then I will ask Mr. Edwards to take over the questioning. Mr. Secretary, we, in my view, finally succeeded in Nicaragua because we finally got rid of the elements of Nicaraguan policy that were dividing Americans. This enabled us to march down the same road together.

I think it is important that we try to do the same thing in Salvador. I have a great deal of respect for President Duarte, who just died. I have a great deal of respect for President Christiani. I happen to believe that he personally is a man of good will and wants to do the right thing.

The problem that I see is that we are bound to have what could be a very divisive argument on Salvador—unless something new happens. We have provided $3.9 billion to Salvador over the past 10 years. We still have renewed attacks on church personnel. We have the rebels who are still able militarily to devastate sections of the capital. We have murder of the Jesuits. We have the continuing resistance of the military to any significant reform. We have a court system in Salvador which is a joke. And I am concerned that the pathology within that society, at least within elements of that society—certainly not all of it, but elements—runs so deep that it may be almost impossible for us to change it from the outside.

I was told, for instance, by a business leader in Salvador who was trying to help President Duarte that it felt pretty funny sitting down at the Rotary Club knowing that fellows across the table had twice run hits on you and tried to assassinate you. That is the situation we are dealing with when responsible people try to move toward peace.

I think if we are going to avoid a real Donnybrook on this issue, it is essential for the administration to do with Salvador what Mr. Edwards was suggesting with respect to the remainder of the foreign aid budget. I mean no disrespect to you or anybody in the administration, but sometimes to bring people together we need some additional players or something new. I think it would be very useful for the administration to have its Salvadoran policy subjected to a thorough-going independent review by somebody you trust and who is trusted generally in this town, much as President Johnson submitted a Vietnamese policy to a thorough-going review by Clark Clifford many years ago.

I do not want to see us pull the plug on Salvador, but I am not at all convinced that our existing policy is in fact going to produce progress unless Mr. Christiani can get a great deal more support from right wing sources in Salvadoran society than he has had to date.

And that is enough said on it from my standpoint. I urge you to consider that as one way to avoid the continued American division, which is otherwise inevitable in my view.

Secretary **Baker**. Mr. Chairman, can I suggest what I think might be a better way, and I suggested this yesterday before the Senate Budget Committee. I think it would be really unfortunate if we now divide here in the United States on El Salvador and find ourselves polarized on that the way we were for so long on Nicaragua.

We have within our reach the goal of a totally democratic western hemisphere. If the insurgency in El Salvador can reach an accommodation with the government of El Salvador, there will only be one government left out there, and it will be pretty well isolated. And, of course, that is the government of Cuba.

So I think what we ought to do is take a lesson from what we accomplished with respect to Nicaragua, with respect to the bipartisan accord, and see if we cannot find some basis for accommodation that would permit us to pursue a bipartisan policy approach.

We have seen what we can do when we see to it that politics stop at the water's edge. What is really needed is for the FMLN now to agree to a cease fire and agree to negotiate with the government of El Salvador under U.N. supervision. I am glad to hear what you said about President Christiani, because we have great respect for President Christiani, the first president in the history of El Salvador ever really to charge elements of the military with respect to criminal involvement in situations like this.

What we do not want to see happen is to see there be a reversal of the results of ballots by bullets and bayonets. And that is really what the FMLN is trying to do. Our policy is succeeding. The policy of supporting democracy and freedom in El Salvador really is succeeding, Mr. Chairman. We have had five certifiably free and fair elections.

And it would seem to me that the executive and legislative branches and the two parties could find a way to come together on how we move in the future with respect to El Salvador. And I would welcome the opportunity to further consult with you and other members of the Congress on this.

I think just submitting the question to a third party really will not get us where we need to go. Because we will not have any assurance, and you probably will not have the assurance you need that the conclusions of the third party would be binding or adhered to by the other branch.

Mr. **Obey**. I am not suggesting at all that their conclusions would be binding. The problem in this town is that after a while everybody begins to believe their own baloney, no matter what side of the political fence they are talking about. This issue, this issue has gone on far longer than the debate on Nicaragua, at least in its recent incarnation. My only point is that we succeeded in Nicaragua because there was a different approach which brought people together.

I am not the permanent president of an optimist club. I mean Archie the cockroach is my favorite philosopher. He said, an optimist is the guy who "ain't" had much experience. I am concerned that, on Salvador, Archie is right. While you may think that we have been winning in Salvador, there are a whole lot of people in our society who do not, and there are a whole lot of Salvadorans who do not. And without debating about whether we are or not, I would like to find a way for us to stay together.

Secretary **BAKER**. Me too.

Mr. **OBEY**. That has to be credible in the means I think that we have got to have. We have to have a fundamental review of policy with no assumptions about whether it is failing or succeeding. Just a fundamental review to see whether or not, in light of the new conditions, our policy mix today is what it needs to be to succeed.

I am sorry. I am going to have to run to the floor. I apologize for taking so much time, but I do not think I will be able to be back. And so, I assume the other members will have a good deal of time to question you.

I will ask Mr. McHugh to take over at this point. Thank you very much.

Mickey, please go ahead.

Mr. **EDWARDS**. I volunteered to take over. [Laughter.]

I am a little confused by all of this. I started out in my remarks suggesting that, as we turn our attention to strengthening democratic institutions, perhaps we ought to reduce some of the military assistance that we have been giving. And now the Chairman is praising President Christiani. I do not know, maybe Mr. Walesa and Mr. Havel and Mrs. Chamorro are going to somehow be able to bring this committee together. And it would be a welcome thing.

First of all——

Secretary **BAKER**. They would get a Nobel Peace prize for that, would they not? [Laughter.]

EARMARKING

Mr. **EDWARDS**. I have a couple of questions only, but first a comment.

You suggested, Mr. Secretary, that you would be amenable either to doing away or reducing the amount of earmarking by the Congress, which I would certainly be very much in favor of or, as an alternative, an across-the-board reduction that affected everybody, as opposed to what Senator Dole had suggested.

I did not like Senator Dole's proposal. I did not think it was well thought out saying that we are going to get more money by taking it away from those people who are our highest priorities. But I have to say, I also have the same reservation about across-the-board cuts, because it does away with our main responsibility, yours and ours, which is prioritization. And there are some of the countries which perhaps ought to be cut and some ought to be increased.

I certainly would like to emphasize that, if at all possible, we reach an agreement where we either do away with the earmarking all together or we greatly reduce the earmarking, so you will have that flexibility either to increase or decrease where it is needed.

I have two areas of questions. We are in agreement, obviously—and maybe everybody in the committee—that our emphasis needs to be now on strengthening democratic institutions in a variety of ways. We have used the National Endowment for Democracy to some extent, a very fine organization, to achieve some of those ends.

But we have to help countries that have no free market, develop one. Where they are starting from scratch, they have not only not the production, but they do not have a distribution system. They do not have a pricing system. They do not have a means either for a democracy like ours or parliamentary democracy. They have no experience with elections.

I am wondering if you could expand on what role you see for the United States in helping to do as you suggest, strengthening these institutions, and how much of that involves appropriations by the Congress, how much of it involves the private sector. What vision do you have for how the United States fulfills that role that you outlined?

Secretary BAKER. Mr. Edwards, let me say that I think there are some things that are clearly needed and desired, particularly, by some of the emerging democracies in Eastern Europe. In Czechoslovakia, for instance, they make it very clear. They are not asking for aid. They want trade and investment.

And getting them trade and investment opportunities means taking on some of the political interests in the United States that serve to sometimes close some of our markets, frankly, to the goods of others. As you know, we have some problems in this regard. But that is number one.

And, therefore, I think trade and investment opportunities should be enhanced. The Caribbean Basin Initiative is being debated this very moment over in Senate Finance. And I would hope that that bill could be enhanced a little bit in the area of textiles and leatherwear. That would give a big boost to some of the small countries in the Caribbean that we have had to zero out because of, among other things, earmarking, and because of a shortage of funds.

It would help Panama, Nicaragua and countries like that tremendously, if we could just give them a little bit better access to our markets. So that is number one.

Second thing I think we need to do is to assist in every way we can in the establishment of a private sector in these countries. You mentioned that. We can do that through appropriated funds, and much of the money that we have asked for Eastern Europe will be devoted to enterprise foundations.

We have done it now for Poland and Hungary. We have created those. I think it would be appropriate to create some of those for some of the other emerging democracies in Eastern Europe.

But some of that private sector creation can be accomplished otherwise than through the Federal budget. And I think that there are plenty of United States private sector interests that are interested in being involved there. We are negotiating commercial agreements now with those countries, so that they can get the benefits of most-favored nation trade treatment. We are also negotiating with most of them either tax treaties or bilateral investment treaties or both.

So that is the second area or category. And there I would submit that it is a mix of private and public funding. I think there is room for a Democracy Corps of some type. And we are still in the process of developing our ideas on this.

But I was struck in my travels through Eastern Europe recently by the degree to which they do not really have any experience with the democratic process. They do not understand how to conduct elections or to run campaigns. And they need some assistance in that regard. And we can help. And the National Endowment can be helpful there, but we can help through some additional volunteer means and mechanisms. And maybe there is some little room there for some appropriated funds, but primarily that would be private sector.

There is a desperate need and desire for people to teach English in these countries. And the Czechoslovaks particularly said, please help us bring people into Czechoslovakia who will teach the English language. Part of this is a desire simply not to be swallowed up by neighbors and teaching of other languages.

But we need to find a way to respond to that, and that can be done both publicly and privately. Publicly, through the Peace Corps, but privately through some sort of a volunteer organization. And we are working on that concept as well.

And then, of course, there is just the overall general concept of volunteerism encouraging that. That is not something that there is a rich history of in these countries. And so there are five areas that I think we can be very helpful to them in, and they require a mix of public funding and private effort.

Mr. **Edwards**. I appreciate that response. As the world is changing and we have all these great new opportunities, our society has not changed greatly.

All of us who have town meetings and talk with our constituents are aware that there really is not a constituency for an increase in foreign aid. Maybe there is a greater need, but there is not a constituency for it. There is still a lot of isolationism in this country. There is a lot of xenophobia partly because of the trade problems in this country. And so the more we can rely on the private sector to achieve these things through volunteer efforts, the better off we are going to be.

NICARAGUAN TRANSFER OF POWER

I have one additional question, and I will say, unlike the Chairman, I am going to have to leave for a few minutes. I have a constituent in my office waiting, but I will be back as soon as I can. But let me ask this because I have been following what happened since Mrs. Chamorro's victory.

I was concerned by President Ortega's comments about the fact that he was going to continue to govern the country from below without the office of President. The Sandanista army is essentially an arm of the Sandanista party, as are the security forces.

In talking with some members of my staff about my immediate reaction to the election, there was talk about doing those things which we could in this country to strengthen Mrs. Chamorro in her negotiations with the Sandanistas, and my reaction was what are we negotiating about? She won the election.

But the reality is that she has, even this morning in reading the Post, had to very strongly come back at Mr. Ortega and say she is going to run the country. She was elected. She is in charge.

I see a real confrontation possible there, and I would like to know what your assessment is of that situation in terms of a transfer of power. What can be done to pry the Sandanista military away from the control of the party and make it truly a Nicaraguan military? How are we going to resolve this conflict that continues even after the election?

Secretary **Baker**. Mr. Edwards, first of all, let me say that I think, as I mentioned yesterday, that there will be a peaceful transition.

I think it is going to take the good faith efforts of all who are interested and involved in Nicaragua to accomplish it.

I also think it would be, as I mentioned earlier, very, very unfortunate if we divide up here on exactly how that should happen, what the tactics are or who should do what first.

But let me say that it has been made very clear in discussions in Nicaragua between Mrs. Chamorro and Daniel Ortega and representatives of the observer groups that she will be the commander-in-chief when she takes over as leader of the country, that she will have the unfettered right to appoint the Minister of Defense and the Minister of the Interior, that there will be and is a recognition of the campaign platform of UNO to the effect generally that there will be a reduction in the size of the standing army of Nicaragua by 50 percent or so.

I am not going to try and interpret the statement that Mr. Ortega made, beyond noting some objective facts one of which is that the Sandanistas will have 30-plus seats—I do not have the exact number, but maybe 38 or so, 39, seats—in the assembly, and as such they will be the largest opposition party. So they will have in that capacity a say in the governance of the country.

The UNO coalition is just that. It is a coalition of a number of parties. They managed to unify in the first instance, and they managed to stay unified throughout a long and difficult election campaign.

So I feel comfortable with respect to their continuing to maintain their unity, but I think you have to recognize that there is a 38-seat one-party opposition in the assembly. Those are the comments that I think I would make in answer to your question.

Mr. **Edwards**. I do not have any additional questions, Mr. Chairman, but one quick comment. While we are talking about the variety of people who can take some credit for what happened in Nicaragua and we are talking about the reintegration of the Contras into Nicaragua, I do not think we should lose sight of the fact that in my opinion, at least, what happened there, especially the elections, would not have taken place if it had not been for the young Contra men and women who gave their lives trying to bring democracy to their country.

It turned out that that was not finally the way in which the result was achieved, but I am convinced that the Contras played a major role and without their presence, there never would have been the elections.

I think all the people of Nicaragua and all the freedom loving people around the world owe a real debt of gratitude to the people who fought for the Contras and died for them.

Secretary **Baker**. Mr. Edwards, I would very strongly agree with that, and let me say further with respect to the particular issue of the Contras, in March of '89, you know, we specifically stated that our policy was to encourage the voluntary reintegration of the resistance under safe and democratic conditions.

We still feel the same way and that is that the reintegration should be, must be voluntary. At the same time, we think those conditions as a consequence particularly of the election are now rapidly being created.

But this is a very complex issue and it has got to be handled with a great deal of sensitivity and care. It has got to be handled in consultation with the Contras. Of course, one of the first things that we did on the morning following the election was to send a high level representative of the United States to the Contras to be in touch with them to let them know that our position remained the same and that we were going to do what we could to assist their voluntary reintegration under peaceful, safe and democratic conditions.

I think it is important to note that both sides now are respecting a cease-fire. I said yesterday that I thought the war in Nicaragua was over. I believe that. I think most people believe that, and it is important that both sides refrain from activities that would tend to provoke the other.

It is going to be obviously a lot more difficult for two armies ultimately to come together than it will be for the rest of the population, but I am convinced that with the good faith efforts of all who are involved, it can happen and will happen.

Mr. **Edwards**. Thank you.

FOREIGN AID BUDGET PRIORITIES

Mr. **McHugh** [presiding]. Mr. Secretary, I would like to join with my colleagues first in thanking you for being here and for the work that you are doing on behalf of all of us.

First a comment, and then I would like to come back for just a moment to the Nicaraguan issue.

By way of comment, I think that as others have said, this budget proposal does not reflect in my judgment and certainly in the judgment of others, perhaps including you, the realities that we are now facing. And I want to compliment you on your statement that you will reach out and consult with us about how these priorities should be adjusted in the budget process, because I can foresee as we begin writing this bill a process which may not work out in a very orderly fashion as people try helter-skelter to change the numbers in this budget proposal to reflect the changes which have been taking place so rapidly.

I take your point and I can understand it that when you were preparing the budget proposal the circumstances were not the same and so it would be unfair of us to hold you to each and every number that is in here. But the truth is foreign aid is not going to go up in the aggregate unless we get some broader agreement on the budget, which seems at the moment unlikely.

If domestic programs continue to be under strain as they are, it is unrealistic for us to think we can increase the foreign aid budget. And, therefore, we have to find within the existing numbers room for some of the things that are now banging on our door.

And you have mentioned them: Nicaragua, Eastern Europe, Panama. Mrs. Aquino is very antsy these days about her own level of assistance and so on, and so I think there is going to have to be some major readjustment and surgery on these numbers. And if it is not done in consultation one with another, I can see a terrible process unfolding here.

And so I want to encourage you to as early as you can reach out and engage us in this review.

REINTEGRATION OF NICARAGUAN CONTRAS

Going back to Nicaragua for a moment, I would like to press you a little harder on what you see by way of the reintegration of the Contras and specifically whether this will involve some additional resources from us to foster this process of reintegration.

We have, it seems to me, a very narrow window within which to work if the Contras are not at least in the process of reintegration by April 25, which is the date Mrs. Chamorro is to take over officially, there is at least a prospect that elements of the Sandanistas will not cooperate in this transition.

We would all deplore that lack of cooperation, but nonetheless it seems to me as a practical matter reintegrating the Contras or at least beginning the process in a meaningful way is important between now and then.

Will this involve additional American aid and if so, when might we expect a request from the administration and in what form might we see that request?

Secretary **BAKER**. We have got, as I understand it, Congressman, about $7.3 million left in the pipeline in terms of humanitarian assistance for the resistance. $3.8 million of that has been obligated to continue humanitarian assistance through April of 1990; that is, until May 1.

The remainder is available to facilitate the voluntary repatriation of those members of the resistance who want to return to Nicaragua. And so, we do have some money left that is available.

It is probably not going to be enough to repatriate the entire resistance if they all determine that they want to go back. And again, let us all remember that we are talking about voluntary repatriation because that is what Esquipulas called for. That is what the agreements down there among the Central American presidents called for. That is what our bipartisan accord called for. It is not a case of forcing people to do something against their will.

But we are going to be encouraging that. We have already started. As I indicated to you, we have been in touch with them. We have made statements such as I made here this morning to the effect that we think conditions are coming about that will permit their reentry into that society under safe and democratic conditions.

So, we will have to continue to work the process, and I really think we ought to be optimistic that we can bring this about.

Now, at the same time there has got to be some good faith efforts on the other side as well. There has got to be a clear continuing clear recognition that there will be a peaceful transition, that Mrs. Chamorro has won an election, that she will be the commander-in-chief, that she will appoint the defense minister, she will appoint the interior minister, that the campaign promises of UNO will be within her power to carry out.

It is that type of process that we are going to see, I think, unfold over the next 60 days.

Mr. McHugh. I agree with what you just said, but I am not sure I am as optimistic as you because what I see is money allocated for humanitarian assistance to maintain the Contras in place through April.

And there is likely to be a certain inertia on their part so long as they are maintained in Honduras with this humanitarian assistance. It seems to me we might have to take a somewhat more proactive approach on the side of reintegration providing some financial incentives to get them to move, to make a decision if we think it is important that their reintegration or movement take place before April 25th.

Secretary Baker. Well, this money can be used for voluntary repatriation.

Mr. McHugh. Well, how is it being used now for voluntary repatriation?

Secretary Baker. It is available to them for transportation to new locations, basic human needs, vocational start-up costs. I mean, it is available for commitment to that both under the bipartisan accord, under the legislation that appropriated the money, and those would be, I think, reasonable inducements to resistance members to come back in.

Mr. McHugh. I do not want to beat a dead horse. I just want to urge you to use whatever active inducements you can now to encourage the contras to either reintegrate in Nicaragua, which I agree should be a voluntary reintegration, or, in the alternative, to do something else.

Let me just ask, before closing this subject, what happens if the contras choose not to go back to Nicaragua? Clearly, the Hondurans do not want the contras in their border areas indefinitely, so what happens to them if they chose not to go back?

Secretary Baker. Well, Congressman, I am not willing to play those games, if I might say so. What happens if the Sandanistas refuse to peaceably transfer power? We could play all sorts of games here. I do not think that is productive.

Mr. McHugh. I am not playing games, Mr. Secretary. I think it is a very practical problem here.

Secretary Baker. I do not think it is. I think we should jointly work together to see that that hypothesis does not come about, just as we should jointly work together to see that the reverse of that hypothesis does not come about; that is, there is a refusal on the part of the Sandanistas to peacefully transfer power.

Mr. McHugh. I agree with that, Mr. Secretary. We should work together. That is very nice.

I think it is very critical, also, that between now and April 25 we work together very vigorously if we expect the transition to take place as smoothly as we both would like.

THE MIDDLE EAST

I would like to go to the Middle East and give you an opportunity to briefly summarize where you are at this point in your efforts to get the Israelis and the Palestinians to talk directly, something which is a significant political problem.

Here, I would like to commend you again, if I may, for handling this rather sensitive effort in a way which is designed to bring these parties together.

Perhaps you can tell us in brief where you are in that process and if we are likely to see talks directly between Palestinians and Israelis shortly.

Secretary Baker. Let me say, Mr. McHugh, that we have throughout this directed our efforts at trying to implement Prime Minister Shamir's election proposal. He asked us to help produce a Palestinian partner for dialogue and elections, and, working with Egypt, we think we made some headway. But we are not home yet.

We have succeeded, I think, in making his initiative the centerpiece of all of our diplomatic activities on this issue over the course of the past eight to ten months. I hope that that is, in and of itself, some achievement. It may not be if we are unsuccessful in getting to a dialogue.

We hope very much, therefore, that we can take it to the next level and actually make implementation possible. We are coming very close to the time when we will know one way or the other whether we are going to have a chance to succeed or not. We have really done pretty much all we can do, we think, from our end, and we are awaiting a response from the Israeli government.

Mr. McHugh. So at this point the next step is for the Israeli government to respond. What is the specific question to which they are to respond?

Secretary Baker. Well, it is a question of how the agenda would be handled in a dialogue and what sort of representation there would be with respect to Palestinians who might attend. Those are the primary issues.

We will also at some point have to get into the question of participation in such a dialogue, if any, by outside parties and that sort of thing.

Mr. McHugh. So one of the key questions here is whether Palestinians who live outside of the territories would have any direct role in these talks?

Secretary Baker. I think that is too narrow a definition of it, Congressman.

Mr. McHugh. Why?

Secretary Baker. I do not think it is quite that narrow a question.

Mr. McHUGH. This is a key question, is it not?

Secretary BAKER. It is an important question. The question is really how we can bridge the gap that exists between the views of Israelis and Egyptians on that particular issue.

Mr. McHUGH. That is an important question, though?

Secretary BAKER. Yes, sir.

Mr. McHUGH. It has not yet been resolved?

Secretary BAKER. Yes, sir.

Mr. McHUGH. One of the things we keep hearing from our Israeli friends is that the PLO continues to sponsor military activity, cross-border attacks against Israel. The Israelis are concerned, as you know, about our dialogue with the PLO for this reason, and it is undoubtedly one of the reasons the Israelis resist participation by certain types of Palestinians. So the question of what the PLO is or is not doing is a very important question in that context.

What can you tell us at this point about whether or not the PLO and, more specifically, Mr. Arafat's Fatah wing of the PLO is doing with respect to military activity against Israel?

Secretary BAKER. Mr. McHugh, let me first say that you are quite right when you say there is some concern on that score in Israel. We have made it quite clear in the course of our dialogue with Israelis and Egyptians that all parties understand that Israel will only sit down with people which it determines it is willing to sit down with. We start from that, and I think everybody understands that.

The dialogue that we carry on in Tunis is not a dialogue that is involved in the discussions we are having. It is not the channel through which we have carried out the discussions we have had on the peace process and the implementation of the Shamir initiative.

From time to time when there have been incidents, we have raised those incidents through our dialogue in Tunis, which is the only channel that we use to talk to the PLO. We are satisfied that the commitment that was undertaken, I think, in December of 1988 has been adhered to and is being adhered to.

We are quite conscious of the fact that Yasser Arafat does not control all elements of the Palestine Liberation Organization. There are some elements that are quite hostile to him which are engaged from time to time in terrorist acts. We do not think and we have not received or seen evidence of complicity or encouragement or acquiescence by him of terrorist activity.

SENATOR DOLE'S PROPOSAL

Mr. McHUGH. Finally, after which I will turn it over to my friend, Mr. Lewis, I would like to be clear, if I could, about your administration's position on the so-called Dole proposal.

I have heard what you said earlier in principle. You are open to considering shifts in resources so long as it is done fairly. You have, I think, implicitly suggested that perhaps an across-the-board approach might be appropriate, although Mr. Edwards and others, including me, frankly, would have some reservations about that.

What can you tell us about Mr. Dole's proposal specifically? Does his proposal of a 5 percent cut for the largest earmarked countries meet with approval by the administration? It is an across-the-board approach. Is this one of the approaches that might fit within your generally acceptable approach?

Secretary **Baker**. The only real argument we have with his approach is it is country specific.

Mr. **McHugh**. That is because these are the largest recipients.

Secretary **Baker**. I understand that, but I think frankly that is the weakness of limiting it to those five countries.

There is a shortfall, and we are earmarked to the tune of 92 percent in FMS and 82 percent in ESF, respectively. If you are going to create a discretionary fund, therefore, it would seem to me only reasonable that you would create that fund out of all of the earmarks, not just the earmarks of some countries.

Mr. **McHugh**. So a 5 percent cut on all earmarked countries would be acceptable as a way of finding resources to deal with these new challenges?

Secretary **Baker**. If we could not find them some other way, I have already said here this morning that an elimination of earmarks would be the preferable way. That is not likely to happen; therefore, we would support some sort of shaving of earmarks across the board if it was necessary to be able to respond to changing foreign policy priorities. If it was necessary to avoid zeroing out the Jamaicas and the Honduras and the Guatemalas and the African countries—and you are very interested in Africa, Mr. McHugh. Do you know what the Economic Support Funds for all of Africa were last year?

Mr. **McHugh**. What?

Secretary **Baker**. $14 million for all of Africa, because there is nobody up here lobbying to earmark African accounts, and there is nobody doing that with respect to the smaller countries of the Caribbean, either. With respect to a lot of countries in Latin America there is nobody doing that.

So when you tell us, okay, here you are, 92 percent of it is earmarked, now go spread the balance among all these other countries, the funds are not there to do it. So there is no way that we as a government, you and we, can respond to the changing foreign policy needs and priorities of the United States.

Mr. **McHugh**. Mr. Secretary, I agree with you, and I agree with what the Chairman has said. The earmarking process has gotten out of hand, and it has limited your flexibility.

As you have indicated, this committee has been more sympathetic to that problem than perhaps some others have been, and I hope we can work together in resolving it because the current situation, including the current budget proposal, from my perspective is not realistic in light of these other challenges to our foreign policy.

Mr. Lewis.

RESPONDING TO FOREIGN ASSISTANCE NEEDS

Mr. **Lewis**. Thank you, Mr. Chairman.

Mr. Secretary, let me add my welcome and my appreciation for the very difficult challenge that you have as Secretary of State.

Our hearing yesterday was a fascinating panel involving a number of experts helping us to focus largely on Eastern Europe. Most of the message of that panel was urging this committee as well as the Congress to be willing to take some risks relative to the kind of assistance that we might make available. It struck me that the need for anybody to suggest that we should be willing to take risks without any doubt in part lies from the fact that most of our constituents want us to send no money called foreign aid overseas.

At home when I have a community forum of sophisticates, maybe 300 people, I will ask the question, how much of our budget goes to foreign aid. I have never had a suggestion come from the audience that was any lower than 15 percent of our budget, and usually they believe it is a lot higher than that. You know, it is closer to almost 2%.

It seems to me that that public response is one of the reasons our foreign policy tends to be reactive to yesterday's crises rather than long term concerns.

I wrote a letter to the President in response to the Dole proposal. I believe I sent you a copy, Mr. Secretary. I tried to begin to address what I think might be one of the longer term elements as well as opportunities that are immediately before us.

You suggested we are not likely to eliminate earmarking quickly around here, and there obviously are some problems with the form that earmarking is taking.

I would suggest without any question that as we go into a quality build-down in the military that this is the time for leadership within the administration and risk on the part of our committee relative to increasing our responsibility in terms of foreign affairs. If we cannot use this opportunity to raise the level of contributions generally and help us get around at least this problem of earmarking while we address the other question, then we miss a very significant opportunity.

In the short term, it seems to me, while you have a supplemental moving that addressed initially Panama, there will be add-ons to that as it relates to other problems as radical changes take place since you put together your budget. If we cannot use that as an opportunity for expanding the real dollars, then I do not know where we go from here.

If the administration, as you suggest, responds to a $400 million credit for housing in the Middle East, what does that do to the rest of our credits without some expansion of the program?

I know you are not used to having people who are considered to be from the right of this committee suggesting we should expand foreign assistance, but sometime we have to really develop a plan, working together in that connection.

Any comments?

Secretary **Baker**. The preferred approach, as I think I have indicated, Congressman, is that we would love to see an enhancement. I mean, that would be the preferred way to solve this problem. We do not suggest an enhancement at the expense of a tax increase on the American people; but it is such an acute problem that if we are not going to get an enhancement then it is far better, we think, to provide some flexibility by shaving earmarks across the board than to just sit here and not respond to these changing foreign policy priorities.

So I do not quarrel with the philosophy of your approach if there is a way to do that.

Mr. LEWIS. One of the ways, Mr. Secretary, that I would suggest and which I think is important to have on the record, those parties who are most concerned about earmarks at least ought to help us in developing broad base support for such suggested enhancements.

Secretary BAKER. Help us in developing some sort of a discretionary or flexible fund that we could use to respond to situations such as Panama or Nicaragua or Eastern Europe, as they occur.

NEUTRALITY OF A UNIFIED GERMANY

Mr. LEWIS. Moving just for a moment to the Eastern European discussion, one of the items that is of interest to a number of the members outside of this Committee is what will be the future of a unified Germany? Japan is, we know without question, a major economic power in the world, and it is likely that Germany will become the same, or is.

One of Japan's real assets is that they have not had to spend significant portions of their GNP on military. What is the administration suggesting relative to the future military condition of Germany? Is there any discussion regarding a demilitarized Germany as they are unified?

Secretary BAKER. There has been a fair amount of discussion and opposition to a neutral Germany, Mr. Lewis. The United States and all other NATO countries are opposed to the concept of a neutral Germany.

I am not sure that there are not a lot of Eastern European countries and perhaps even, indeed, the Soviet Union that might have some problems with a neutral Germany. In our discussions on German unification it is quite clear that all of the countries of the West—the western alliance and many of the Eastern European countries, or Central European countries—would support a unified Germany as a member of the NATO alliance.

Mr. LEWIS. With an independent military force?

Secretary BAKER. Well, as a member of the NATO alliance.

Mr. LEWIS. There is a lot of discussion out there in the halls of the Congress reflecting concern about the long-term potential of that. The fears of the past, of course.

Secretary BAKER. Well, let me say there has been further discussion and the German leadership—the leadership of the Federal Republic—has made it quite clear that they reject the notion of a unified Germany with an independent nuclear capability.

Mr. LEWIS. I hear you clearly, but indeed I hope——

Secretary BAKER. Well, Germany has now, a Bundeswehr. They have an armed force. They would continue to have that as a unified Germany, a member of NATO.

Mr. LEWIS. You talked about, as we hoped to support strengthening the democratic institutions——

Secretary BAKER. May I say one final thing, just so the record is clear?

There have also been discussions—none of this of course, has been finalized because we have a mechanism, or a framework, for discussing these matters now, the so-called two-plus-four arrangement—that there would be no extension eastward of NATO's forces under the scenario that we have just discussed. That is, a unified Germany as a member of the NATO alliance.

DEBT REDUCTION

Mr. LEWIS. Looking at the European countries, it is clear that one of the major factors to deterrence of strengthening democratic institutions, but especially impacting economic development potential, is the overhang of debt.

Yesterday, we talked a lot about a very high percentage of that debt being official debt, and it was suggested that that official debt is largely on the books with zero income and one could very easily, in the minds of some people look, towards the write-off of some of that debt.

On the one hand, I am interested in knowing if you are discussing that as a part of policy, and secondly, if you have considered conditionality relative to such write-offs of official debt. Specifically I am thinking, myself, of proposals being made by American universities who want to participate in the technical assistance, strengthening the cadre of people who help with the economy, et cetera, a piece of that debt being prioritized as debt for development, for example.

Secretary BAKER. Congressman, I am not aware of any discussions with Eastern European countries involving the issue of debt forgiveness, official debt forgiveness.

As you know, we have some legislation that was passed as a consequence of the agreement among the Group of Seven nations at the Toronto Summit with respect to the forgiveness of debt of the poorest of the poor in Sub-Saharan Africa. That is the only authority that I am aware of that we have in the United States to forgive official debt, but I am not aware of any discussions that have taken place with respect to that.

Mr. LEWIS. Poland, for example, has some $40 billion debt, a significant part of that being an official debt on our books; Poland cannot pay. It is suggested that outside new investment of significant levels will be greatly deterred by that debt overhang.

Secretary BAKER. Well, investment in state-owned institutions and state-owned properties, perhaps, but if we are successful in developing a private sector, maybe not.

Now, there have been discussions of extremely liberal rescheduling terms for official debt of some of these countries, particularly Poland in The Paris Club, and that has, in fact, taken place, and really was taking place to some extent before some of the political reforms that we have seen.

Mr. LEWIS. That testimony did specifically suggest that even private sector development could be significantly negatively impacted in terms of investment willingness because of the debt overhang.

Mr. Chairman, I would like to take the whole morning, but I would yield.

Secretary BAKER. Well, Mr. Lewis, just following up on that, there have been some quite beneficial arrangements agreed to by official creditors of The Paris Club for some of these emerging democracies, and Poland comes to mind.

Mr. McHUGH. Thank you, Mr. Lewis. Mr. Secretary, it is now ten till 12, and I think we should check to see precisely when you have to leave. How much time do we have?

Secretary BAKER. 12:00.

Mr. McHUGH. I have a feeling your staff is being overly conservative.

Secretary BAKER. I have a meeting with the Director of Central Intelligence at 1:00, so if I can get away from here by 12:05 or 12:10, maybe we can make it. I have got to eat lunch, too.

Mr. McHUGH. Mr. Coleman?

AID AND DEBT IN CENTRAL AND LATIN AMERICA

Mr. COLEMAN. Thank you, Mr. Chairman. Welcome, Mr. Secretary.

I would only say that from our region of the country, in Texas, I think a lot of us understand the requirements that we now have really upon us in terms of our interests in foreign assistance because of the events that have occurred.

I think your statement appropriately points out that this is not the time to be cutting corners or saying that we cannot do things because the threat is not there in the way that perhaps it used to be. In fact, I agree with you, I think the threat is now even more dangerous. If we do not now support burgeoning democracies we will rue the day that we did not, and this could be that year.

I wanted to say to my colleagues on this Committee that when the 302(b) allocations are made, the giving up by this Committee once again of our allocation to domestic spending (and the rest) should be avoided. I think that is going to cause the administration to have to look for funds. Either that, or we have to remove Gramm-Rudman requirements and borrow more money.

I would only say that I think we are coming to a crisis in that regard, and I say that advisedly to my colleagues on this Committee. I think that cutting back, as the Secretary points out this year, will be one of the worst things we could possibly do.

From our region of the country, our concern is, also, Mr. Secretary, that while we want to provide assistance in Eastern Europe for burgeoning democracies—perhaps in a fund as suggested by I think your own statement, by Senator Nunn the other day—and by professors who addressed this Committee the other day—if they can meet certain tests in terms of human rights and other issues, a lot of us feel that perhaps we are neglecting Latin America.

I noticed that while some of my colleagues; attention is directed to the current events of Central and Eastern Europe, and even while we see things in Nicaragua and Panama, are we forgetting, perhaps, the context in which these problems are occurring in Central and Latin America?

We talk about debt overhang, the term used by our colleague from California, and for gosh sakes, we have known about the international debt situation in Central and Latin American for a long time.

I just wonder if you might care to respond with respect to the Brady Plan and whether it works or does not work, whether we are getting any volunteerism from banks.

From your previous post, perhaps, Mr. Secretary, you could give us some insight as to what it looks like.

Secretary **Baker**. Congressman, first of all, before I do that let me simply say thank you for your comments about the importance of supporting these emerging democracies, because democracy can be messy. We all know that.

We also know that the aura, the newness is going to wear off. If the leaders who have brought these reforms to these countries are not able to produce for their people, the day will come, as you put it, that we could rue the day.

So it is really important that we respond and that we react effectively to this change that is taking place, and I really salute you for what you said about the 302(b) allocations, and I hope this Committee, Mr. Chairman, will hang tough.

We all know there is not a big constituency or a consensus out there for foreign aid, but today we are talking, particularly this year, about supporting an extraordinary outbreak of freedom and democracy all around the world, something that we have professed and believed in for 200 years here, and something that we fought several wars for. So thank you for what you have said.

Latin America is not getting the attention that we should give it in terms of foreign assistance, and it is because we do not ear-mark for Latin America, so we end up cutting back, and Africa is getting the same short shrift, and thank you for what you said about that. We are able to increase a little bit this year in our request and in our assistance with respect to the narcotics problem, and particularly for the Andean producing countries.

With respect to the debt problem, it is still there. You will remember that I used to come up to this Committee every year and say this problem did not arise overnight, and it is not going to be solved overnight, and it is not.

I think the approach that the administration is now following is the right approach. There does, of course, have to be a balance between forgiveness and the generation of new funds.

I remember we used to have debates in this Committee about the importance of not cutting these countries off from access to the private financial markets, because they need capital to grow. Preferably it would be equity capital, but if it cannot be equity capital then it has got to be debt capital, and they cannot get that debt capital from the multilateral financial institutions because they do not have substantial enough lending capacity. So we do not want to cut them off from private financial sources.

When you move to debt forgiveness, there is a tendency on the part of directors of lending institutions to say, wait a minute. If we are going to have to forgive it, should we really follow on with some new lending?

The Mexican package contains some new money. Some of the other packages that they are negotiating over there will have some new money components. But it is very important that we realize that the solution to the problem is not simply debt forgiveness, nor is it simply the generation of new capital. It has got to be a mix between the two, and hopefully we are on the path to seeing that happen.

Mr. **Coleman**. In the interest of time, Mr. Chairman, I would be happy to yield.

Mr. **McHugh**. Thank you very much, Mr. Coleman. Mr. Porter?

PRIVATE SECTOR DEVELOPMENT IN EASTERN EUROPE

Mr. **Porter**. Thank you, Mr. Chairman.

Mr. Secretary, in this age of the triumph of democracy and freedom, perhaps divine providence has led us to have a Secretary of State who has a background—a successful background—in both business and as a former Secretary of the Treasury. As I think we have all said this morning, Communism has fallen largely because it has not delivered economically for its people.

I believe that democracy cannot be sustained if the shelves are going to remain bare, and many people have a faith that simply by having democratic institutions, automatically the shelves will be filled. That certainly is not true, and the emphasis we need is upon free economic institutions as well as free political institutions.

You said a minute ago that our emphasis should be on capital development, and it seems to me that we are being pushed by our European allies, particularly by France, in a different direction.

They want to set up, through the European Bank for Reconstruction and Development packages that seem to be direct government to government lending, heavy emphasis on infrastructure and the like. I would urge you to resist that as much as possible and to work through institutions like the IFC that provides money to the private sector. I think that is the only way we are going to see a real change in the economic picture in Eastern Europe any time soon.

Secretary **Baker**. Mr. Porter, we are, of course, negotiating possible participation by the United States in the European Bank for Reconstruction and Development. I think it is fair to say that our friends and allies in Europe very much want the United States to participate.

And again, this gets back to the point that the chairman made at the outset of the hearing about leadership. And leadership and participation by the United States is still desired, I think, across the oceans.

We think that a European development bank could be very helpful in promoting democratic growth and free-market economic growth in some of these emerging democracies of Eastern Europe.

Our negotiation right now is directed at getting greater private sector emphasis on the lending policies of the bank and getting it stated in the charter of the bank, and that sort of thing.

We have some differences with some of our friends on how that bank ought to be capitalized, what the rules ought to be, and that sort of thing. But I think it is important if we can resolve those differences that the United States support that regional development bank, just as we have supported an Asian development bank and an inter-American development bank.

CYPRUS

Mr. **Porter**. Mr. Secretary, let me change the subject. Walls have come down across Eastern Europe, most notably the wall in

Berlin. There is one that remains that we have not really addressed, and I am afraid might be lost in the process, and that is the Green Line that still divides Cyprus, between Greek and Turkish Cypriots.

What can we do, Mr. Secretary, while all the wonderful things are happening, to include Cyprus in this process, end this division, and reunite this nation?

Secretary **Baker**. Well, we are doing what we can, Mr. Porter. It is a very, very difficult problem. We have been supporting, for some time, the efforts of the United Nations Secretary General to get discussions going.

They started again in New York on the 26th of February—two or three days ago.

We have discussed this issue with the Turkish government on a number of occasions, most recently when President Ozal visited President Bush, asking that they encourage Mr. Denktash to come to New York and participate in these UN-led discussions.

Cyprus is a difficult problem, but it is one that we feel should be resolved through negotiation. And we are trying to do whatever we can diplomatically to encourage those negotiations.

Mr. **Porter**. Thank you, Mr. Secretary.

HUMAN RIGHTS IN CHINA AND HONG KONG

Can I ask finally regarding China. Most recently I believe that we have approved, voted for, a World Bank loan to China.

Many in the United States, and it certainly includes me, believe that we have not spoken out or acted forcefully enough regarding ongoing human rights abuses in China, not just Tiananmen Square, but what has happened since that time. And not just within China, but in Tibet, where martial law continues. And the people of Tibet continue to be oppressed by the Chinese Army.

And, in addition to that, there is unfolding at this point in time a completely free economy, and a place ruled by law for the last 100 years, Hong Kong coming under the domination of Beijing under the Sino/British accord, whereby Hong Kong comes under their domination in 1997.

The Basic Law that has been agreed to does not seem to further the interests of free enterprise or human rights in Hong Kong.

Do not we have an interest both in what is happening within China, what is happening in regard to Tibet, and what will happen and is happening in regard to Hong Kong, and what can we do to influence that situation in a way that emphasizes human rights, the rule of law, and a free economy?

Secretary **Baker**. Well, the answer is yes to your question. And we have done some things that emphasize human rights.

First of all, we did vote for the loan that you mentioned. But let us bear in mind that that is a basic human needs loan. And we have now adopted a policy of approving on a case by case basis, basic human needs loans for China, but only basic human needs loans. And then, only if they are spaced out over a period of time.

We continue to oppose, along with I think all the other members of the Group of 7 countries, industrial and most infrastructure project loans or balance of payments loans for China. We continue to oppose military transfers to China.

And the fact of the matter is, Mr. Porter, we have in place sanctions against the People's Republic of China. And we have those in place because of our concern about their human rights performance, the examples that you have cited, including Tibet.

With respect to Hong Kong, it is very important to the United States that there continue to be a stable and prosperous Hong Kong. But it is also very important to the People's Republic of China. Because the destruction of Hong Kong's unique status would really only destroy Hong Kong's usefulness to China.

And we take note of the fact that even in past periods of intense ideological fervor in China, for instance, such as during the Cultural Revolution, the impact on Hong Kong was relatively slight.

So this gives us some grounds for optimism that China will exercise prudence and respect for Hong Kong, and for its unique status as sovereignty reverts to China in 1997.

Mr. Porter. Mr. Secretary, I suggest that what has happened at least since last June regarding Hong Kong has led the people of Hong Kong to an entirely different conclusion. And people are voting with their feet. The people of talent are leaving by the tens of thousands.

And it seems to me that the United States has a responsibility toward this place of freedom to see what it can do to keep it the kind of vibrant economy and place of rule of law that it has always been.

Secretary Baker. I do not deny that there has been some voting with the feet there, Congressman. All I am saying is we have seen instances of concern in the past. Maybe not as strong as in this case. But I think we have to continue to make the case if we want to see a stable and prosperous and free Hong Kong, to the extent that we can.

And we will continue to do that. All I am saying is that in past periods of ideological fervor in China, there has been great nervousness in Hong Kong, and catastrophe has not come to pass. That is not to say that it might not happen this time. We will continue to work against it.

I would simply say one more time, people tend to lose sight of the fact that we have sanctions in place against the People's Republic of China.

Mr. McHugh. With apologies to the senior ranking member of the appropriations committee, I would like to turn to him now for the limited time left.

Mr. Conte.

BUDGET COMMITTEE ALLOCATIONS FOR FOREIGN ASSISTANCE

Mr. Conte. Thank you, Mr. Chairman. I will be very brief so the Secretary can obtain some vittles before his next meeting.

Mr. Secretary, I want to welcome you back to Death Valley. [Laughter.]

Mr. Conte. I know how much you look forward to these sessions. The chairman had these new lights put in so you can see your tormentors a little bit better. That was very thoughtful of him.

I am going to give a speech now—why should I be any different? [Laughter.]

Mr. Secretary, in my opinion, this brave new world we are now witnessing demands extraordinary action right now on the part of both the administration and the Congress. And if I were a tennis player I would say we now have advantage West, advantage democracy, advantage free markets. The ball is in our court. It is up to us to win the game, the set and the match.

But what I see here is pretty much business as usual in the foreign assistance budget, and over in the Commerce, Justice, and State subcommittee, we see the usual levels of requests for the State Department, USIA, the Board for International Broadcasting, the Voice of America, and the National Endowment for Democracy.

Picking up where Congressman Coleman left off, in all respect, Mr. Secretary, I think all of this is crazy. We need more resources right now to take advantage of this unprecedented and perhaps temporary opportunity to win the Cold War.

And where are we going to get those resources?

Well, we can start by shooting down the B-2 boomerang boondoggle, at $500 million apiece. I believe the President should sit down immediately with Dick Cheney, Darman, and some people up here on the Hill to rewrite the foreign aid and the State and USIA 1991 budgets, and even parts of the 1990 spending plans.

The objective should be to replace outdated Hot War expenditures with Cold War spending. This thing is not won yet. There is still a long way to go.

And second, you should work as hard as you can, as Mr. Coleman said, to obtain increased function 150 international affairs levels by the budget committees. We do not have the protection of the budget summit this year. At least not yet. And if you wait until the appropriation process to get higher 150 levels, you have missed the boat.

This subcommittee and the Commerce, Justice, State subcommittee have a responsibility here, also. In the past there has been some skepticism as to how hard the effort has been to get higher 150 levels when we get to the 302(b) process. And I am not being partisan here. It has been on both sides.

Every one fights so hard to get more of the pie for either economic or military aid, that we forget about the size of the pie. We have got to set those arguments aside for the time being. We can and will fight that fight later in the process. We need to work together, right now, to get high enough ceilings to do at least some of the things that have to be done in Eastern Europe and Central America.

We will pay dearly for inaction.

Inspired people created the Marshal Plan after World War II, and we must do likewise. We must be inspired. If you need help, go back and read the speech to Congress by the playwright from Czechoslovakia.

End of sermon. The pulpit is yours, Mr. Secretary.

JESUIT MURDERS IN EL SALVADOR

Only one question. I was outraged, Mr. Secretary, when I read last week that the Colonel who was charged with the murder of the six Jesuits down in El Salvador is living a life of luxury in a fancy apartment and in hotels. We have to see that he gets into jail in a jail cell. That was a vicious and atrocious and disgusting crime that he is accused of.

The United States Government, with the help of the Congress, gives $400 million in aid to El Salvador every year. I cannot believe that does not give us enough clout to get that guy thrown in jail. Why is he not jailed, Mr. Secretary?

Secretary BAKER. Mr. Conte, we were equally outraged. And this is a matter that we are taking up with the El Salvador government. Let me simply say that we share your outrage at that. And it is something that we intend to pursue vigorously.

Mr. CONTE. Thank you, Mr. Chairman.

Secretary BAKER. And can I say one other thing?

FOREIGN ASSISTANCE BUDGET ALLOCATIONS

Thank you for what you just said, as Congressman Coleman had also said, about the importance of the 302(b) allocation this year for a very important national security function of the United States, for which there is not a larger political consensus and constituency out there in the country.

We will never have a better chance to lock in democracy and to lock in freedom. You have got the best shot—this committee, I think, and your counterpart over in the Senate—you have ever had to get a good and substantial 302(b) allocation.

And I sure hope you are going to hang in there and hang tough.

Mr. CONTE. Thank you, Mr. Secretary.

Mr. MCHUGH. Mr. Secretary, in closing, let me say that I think it is clear on both sides of the aisles that you have people who are supportive of you as a pragmatic Secretary of State. You have a subcommittee that cares about America's role in the world. You have a subcommittee that believes foreign assistance is an important tool of American foreign policy.

Earmarkings are a problem. You have stressed that. And we will try to resist them.

I think, frankly, one of the major problems here is the continuing stalemate on a larger budget issue. We need more resources if we are going to be serious about these problems. And the 302(b) allocation should be larger.

But, so long as we have no agreement on the large question of taxes to meet our responsibilities on how the so-called peace dividend is going to be allocated, we are not going to make much headway on 302(b) for foreign aid.

And we do not have the time to get into all of that, but let me say that it is not just an earmarking problem, it is a budget problem which relates to those large issues of where the resources are going to come from.

We have housing problems in this country, and the list is familiar to you. And foreign assistance will not be able to increase in-the way that all of us agree it should, unless we resolve those larger issues in relation to the budget.

We thank you very much for being here. We want to work with you closely so that this foreign assistance budget at whatever level responds in a meaningful way to these challenges.

Thank you very much.

Secretary BAKER. Thank you, Mr. Chairman.

[Questions and answers for the record follow:]

Defense Spending

Question Submitted by Representative Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: How much does the United States presently spend to maintain a military presence in the Western Pacific? How does this compare with U.S. defense spending for Western Europe?

A: Because of the complexities of the answer to your question, we are closely coordinating our response with DOD. We are providing your staff the latest copies of the "Report on Allied Contributions to the Common Defense" which addresses burdensharing in both regions, "Report in Response to Section 1002 (d) (2) (A) of the Defense Authorization Act of 1985" which includes a comprehensive description of U.S. commitment to NATO and the rest of the world, and a new DOD report to Congress expected to be completed in two weeks which lays out operating costs by country.

In the interim, the following are the Personnel and Installation figures for each region. This will give you a rough order of magnitude and a level of effort assigned by DOD to the Western Pacific in comparison to Western Europe.

PERSONNEL

Western & Southern Europe	344,078	16.3%
East Asia & Pacific	146,026	6.9%
Worldwide	2,115,773	100%

INSTALLATIONS

Western & Southern Europe	273	21.6%
East Asia & Pacific	83	6.6%
Worldwide	1266	100%

Northwest Pacific: The Soviet Threat

Question Submitted by Chairman Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: In view of the changes within the Soviet Union and in Eastern Europe, how would you now evaluate the Soviet threat in East Asia and the Western Pacific?

A: There have been dramatic changes in the USSR and Eastern Europe as well as in the East-West relationship. One of the key points I made to Foreign Minister Shevardnadze during our February ministerial was that, as East-West relations move away from confrontation toward greater cooperation, Asia should not be left behind.

Thus, for example, I encouraged Mr. Shevardnadze to look at ways to improve Soviet-Japanese relations, specifically by addressing the Northern Territories issue. I also urged him to use Soviet influence with North Korea to lower tensions on the Korean peninsula.

With regard to the Soviet military threat in Asia, Moscow is reducing its forces in the region. The Soviets have agreed to withdraw their troops from Mongolia by the end of 1991; they are drawing down their presence at Cam Ranh Bay; and they are discussing with China troop cuts along the Sino-Soviet border. There have also been reductions in the Soviet Pacific Fleet.

These are positive steps. I would, however, make two observations. First, the bulk of the Soviet reductions that we have seen in Asia to date have been in ground forces opposite China. While such cuts are welcome, their impact on the military threat against U.S. forces in the Pacific or against key allies such as Japan and South Korea is minimal.

Second, the Soviets have been modernizing their remaining forces, particularly the air and naval forces which pose the greatest threat to the U.S. and our allies in the region. For example, the introduction of newer, more capable warships may mean that the Soviet navy's combat potential remains the same or is improved, despite the lesser number of ships.

Thus, while we see some positive changes in the Soviet military threat in Asia, Moscow continues to maintain potent forces that exceed those necessary for "reasonable defensive sufficiency" and must be of concern to the U.S. and our allies.

U.S. Defense Role in Korea

Question Submitted by Representative Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: How would you define the U.S. defense role in South Korea? What elements of that role is South Korea unable to assume?

A: The presence of U.S. combat forces in the Republic of Korea remains a key symbol of the U.S. commitment to peace and security on the Korean Peninsula. The U.S. is a primary guarantor of the 1953 Armistice which halted war between the U.N. Command (comprised of U.S. and allied forces) and the North Korean People's Army, then supported by the "Chinese People's Volunteers."

Most U.S. forces (principally Second Infantry Division and Seventh Air Force) are stationed in Korea under terms of the Mutual Defense Treaty of 1954 and a Status of Forces Agreement of 1968. The small U.S. contingent assigned to the U.N. Command provides security for the Joint Security Area at Panmunjom and helps administer the 1953 Armistice. U.S. forces will remain in Korea as long as we and the ROK believe they are needed to deter external aggression from the North.

In support of their role in maintaining the Armistice and deterring a new outbreak of war, U.S. forces in Korea provide vital early warning and other intelligence capabilities as well as the logistical support which would be needed for rapid deployment of U.S. forces into Korea in case of war. Korea is not able to provide these important intelligence and logistical support services. Korea is also unable to provide the symbol of deterrence that is embodied in U.S. ground combat and air forces now in Korea.

U.S. Personnel in Korea

Question Submitted by Representative Obey
House Foreign Operations Committee
3/1/90

Q: What is the ratio of US combat personnel to support personnel in South Korea? What support elements are to be withdrawn in accord with Secretary Cheney's recent statements? What support functions could South Korea take over?

A: DoD is working to provide us the most accurate information possible on this question but has not yet arrived at an answer. An accurate count is difficult to obtain quickly as there are a number of support personnel within combat units such as the 2nd Infantry Division and in Air Force fighter units as well.

We expect that the ratio of support to combat personnel will be quite high. Our plans for reinforcing Korea in an emergency call for rapid augmentation from the United States. A large percentage of our support troops in Korea are there specifically to receive additional US combat forces in time of crisis. The extremely limited warning time we expect to receive should North Korea attack requires that the US maintain the capability to absorb and utilize large-scale reinforcements in a short time.

It is still too early to say exactly what elements will be withdrawn or what support functions might be assumed most immediately by South Korean forces. Those decisions will be made by the Commander of US Forces Korea in consultation with the Korean Ministry of National Defense.

Japanese Support of US Personnel

Question Submitted by Representative Obey
House Foreign Operations Committee
3/1/90

Q: Does the Administration expect Japan ultimately to pay all the costs of US forces stationed in that country? Would this include the costs of operating and maintaining all US weapons systems in Japan? Would this include the salaries of American personnel stationed in Japan?

A: The budgetary outlay made by Japan in support for US forces is greater than that made by any other ally. In 1989, the total cost of maintaining US forces in Japan, including the salaries of US personnel, was approximately $7.5 billion. Japan contributed some $2.9 billion, approximately 37.5% of this total. In 1990, that amount should increase to about $3.2 billion (140 yen to the dollar). In our discussions with the Japanese Government we have continued to encourage Japan to take the initiative to assume a significantly greater share of the total costs.

Japanese Responsibility for Financial Support of US Forces

Question Submitted by Representative Obey
House Foreign Operations Committee
3/1/90

Q: What does the US-Japan Status of Forces Agreement (SOFA) say about the responsibility of Japan for financial support of US troops in Japan? Would the agreement have to be amended for Japan to assume all cost ?

A: Under the 1960 Status of Forces Agreement, Japan furnishes without cost to the US all facilities, areas, and rights of way including those jointly used. The US bears all other expenditures incident to maintenance of US forces stationed in Japan.

Since the late 1970's, Japan has concluded three agreements with the US to assume most of the costs of employing Japanese workers supporting US forces. The Japanese Government considered two of them within the terms of the SOFA and the third a "Special Measure" outside the SOFA which required ratification by the Diet.

Japan also initiated a very generous Facilities Improvement Program in 1979 to fund essentially all new construction -- such as family housing, schools, hospitals, commissaries and exchanges -- to improve the quality of life on US bases. In addition, Japan pays relocation costs and other miscellaneous expenses for US forces.

We believe the SOFA does not preclude Japan from assuming more costs than it presently bears.

Northwest Pacific: Prospects for Arms Reduction Agreements

Question Submitted by Chairman Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: What are the possibilities of arms reductions agreements in the Northwest Pacific? What kind of proposals do you expect from the Soviet Union in the future?

A: President Gorbachev has made several public proposals in recent years (his Vladivostok speech in 1986; his Merdeka interview in 1987; and his Krasnoyarsk speech in 1988) which could involve arms reduction or confidence-building measures (CBMs) in the Northwest Pacific. He has called for a broad negotiating mechanism -- an Asian "Helsinki process" -- to consider security issues in the region; he has proposed naval confidence-building measures in the Pacific and Indian Oceans; and he has sought limitations on air and naval forces in the northern Pacific.

Soviet forces in Asia have been somewhat reduced unilaterally over the past year. But modernization of remaining forces is likely to leave the Soviet Union with very potent capabilities in the region.

In the future we expect the Soviets to elaborate on the ideas they have already put forth, especially in the area of Asian CBMs. We may see calls for the application of the "transparency" principle to northwest Asia, for talks on naval and other conventional force reductions, and for measures to supplement such existing agreements as the U.S.-Soviet Incidents at Sea Agreement or the Dangerous Military Activities Agreement.

I would be cautious in considering these suggestions. First, there are significant differences between Europe and Asia -- for example, Asia does not have a European-style alliance structure. Thus, I do not think an Asian "Helsinki process" would be very workable. Second, while there are many active areas in the U.S.-Soviet and East-West arms control agendas, negotiations that affect naval forces -- as most Soviet Asian arms control proposals would -- do not seem to me useful. Many of the Soviet-proposed measures would unduly restrict the operational flexibility of U.S. forces in the region while leaving Soviet capabilities relatively untouched. It is important to bear in mind that the U.S. is a maritime power, separated from our allies and trading partners by vast oceans, unlike the USSR which has internal land lines of communication. Naval forces are vital to protect the sea lines of communication upon which we and our allies depend, and to maintain overall deterrence. This is why we cannot accept agreements that would adversely affect our security by imposing inequitable limits or undue restrictions on our naval operations. Finally, U.S. forces in Asia play a stabilizing role outside the U.S.-Soviet context; they are not at all threatening to the USSR.

Though we have rejected certain specific proposals which are not in our interest or those of our allies, we are in favor of finding means to reduce tensions. On the Korean peninsula, for example, we believe that confidence-building measures similar to those developed in Europe may have utility.

Philippines Bases

Question Submitted by Mr. Obey
House Appropriations Committee
3/13/90

Q. If the United States loses its base rights in the Philippines, would the Pentagon propose the construction of new bases in the U.S.-affiliated islands such as Guam, Tinian or Palau, or would the Pentagon plan to operate only with other present facilities in the Western Pacific?

A. After the 1988 Military Basing Agreement (MBA) Review, Congress asked DOD to report on the importance of U.S. facilities in the Philippines and options for moving. DOD's report examined a range of potential alternatives to U.S. facilities in the Philippines, including the construction of new bases in U.S.-affiliated islands such as Guam, Tinian or Palau, and the potential costs of these options.

While alternatives exist, we would prefer to retain our facilities and basing rights in the Philippines, under an agreement that is acceptable to both the U.S. and the Philippines. Negotiations for a new Military Bases Agreement with the Philippines will begin soon. They are likely to be difficult, but we believe we will ultimately be able to conclude a mutually beneficial agreement that will allow us to remain in the Philippines.

Philippines Bases

Question Submitted by Mr. Obey
House Appropriations Committee
3/13/90

Q. Are Subic and Clark bases of equal strategic value to U.S. forces in the Western Pacific? Which of the Bases is more easily replaced? What changes in the Philippine base structure could the Pentagon accept in a new base rights agreement.

A. A forward deployed U.S. military presence in the Western Pacific and the bases needed to support it remain essential to our national interests. It is in the U.S. interest to retain access and rights to facilities in the Philippines, including both Clark and Subic. These facilities have different functions, which are not interchangeable.

This said, the U.S. has made adjustments to make its overseas basing posture more efficient. Further adjustments are possible if approached in a careful manner, in close consultation with our allies and with a view towards enhancing efficiency. This larger trend of adjustment will influence the U.S. in its approach to the upcoming MBA negotiations, but specific adjustments to the U.S. presence in the Philippines, if any, will be the result of consultations with the Philippine Government that will take place in the negotiation process.

Singapore Access Agreement

Question Submitted by Mr. Obey
House Appropriations Committee
3/13/90

Q. What is the status of current U.S. negotiations with Singapore over increased U.S. military access to bases in Singapore. If an agreement is reached, what kind of U.S. military presence in Singapore would you envisage?

A. In January 1989 Prime Minister Lee Kuan Yew offered U.S. forces access to Singaporean military facilities. In October 1989, after thorough study by the Departments of State and Defense, Ambassador Orr provided the U.S. response to PM Lee. We offered to increase ship and aircraft visits, including temporary deployments of fighter aircraft for training purposes, and plan to assign approximately 160 U.S. personnel to Singapore on either a permanent or temporary basis to support this increased presence.

In January 1990 Ambassador Orr presented PM Lee with the prosposed text of an agreement regarding U.S. use of Singaporean military facilities. This agreement would be similar to those we have with other countries which have granted us access to their facilities, and includes status of forces provisions to ensure adequate legal protection for U.S. personnel in Singapore.

Negotiations with the Government of Singapore took place from February 26 - March 2 in Singapore. They were cordial and constructive, and consultations on an agreement are continuing. Both sides have reiterated their interest in moving forward on this mutual initiative to enhance security cooperation.

AFRICA'S WARS

Question Submitted by Chairman Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Some of Africa's largest countries, with the greatest development potential, are today afflicted by war. The situations in Sudan, Ethiopia, Mozambique, and Angola are particularly severe. Could you outline U.S. policy and steps we are taking to bring these conflicts to an early conclusion?

A: It is our policy to help end regional conflicts -- and the concomitant human suffering these conflicts spawn -- wherever possible. We also recognize that these conflicts have a high economic cost - both in terms of meeting the needs of refugees and displaced persons and in lost development opportunities. The nature of the conflicts in Mozambique, Angola, Sudan, and Ethiopia and our influence with the governments and factions involved in these conflicts vary. We adapt our peace efforts in these countries accordingly.

At the request of President Chissano of Mozambique, the United States has actively facilitated the peace process between the government of Mozambique and the Mozambique National Resistance (RENAMO) since March 1988. We have been in constant touch with the mediators (Presidents Moi of Kenya and Mugabe of Zimbabwe) and various parties to the conflict; we have met on two occasions with RENAMO leader Afonso Dhlakama with President Chissano's concurrence. In December, we advanced a seven point synthesis of FRELIMO and RENAMO positions which was approved by President Chissano and now appears to have been accepted by RENAMO leader Dhlakama. These points could form the basis for direct talks. During his March 12-15 Washington visit, President Chissano announced his intention to enter into direct negotiations with RENAMO without preconditions. We commended his action and will continue to facilitate direct talks between the warring parties.

During my March visit to Africa, I met with Angolan President Dos Santos, UNITA leader Dr. Jonas Savimbi and the mediator, President Mobutu of Zaire, in an effort to restart the peace process in Angola - a process which has stalled in the face of a major government military offensive against UNITA-controlled territory. Our goal is to obtain the government of Angola's agreement to a mutally acceptable ceasefire and direct negotiations leading to national reconciliation and free and fair elections. Dr. Savimbi has agreed to direct talks without preconditions. The United States supports President Mobutu's role as mediator and will support his efforts to promote a peaceful solution to this conflict.

Our primary focus in Sudan is humanitarian. We work to foster peace, facilitate relief and protect human rights. While we believe peace is the key to improvements in human rights conditions and is closely linked to effective provision of relief, thus far we have not been able to get the government of Sudan and the Sudanese People's Liberation Army (SPLA) to begin serious negotiations. Last December, former President Carter tried to start peace talks between the SPLA and the government. We supported those efforts. Unfortunately, according to former President Carter, neither side seemed serious about the talks and the mediation effort failed. In an attempt to break the deadlock, we have offered a fresh U.S. proposal to get the fighting stopped and talks going again. Both sides are studying our proposal.

We have very limited influence with the Ethiopian government and the insurgent groups, but nonetheless are trying to help end the war and facilitate relief. Both the government and the Eritrean People's Liberation Front (EPLF) told us they wish to continue peace talks in the Carter - sponsored process. We support that process, as well as the parallel talks between the government and the Tigrayan People's Liberation Front (TPLF) under Italian sponsorship. I personally raised US desire for quick-resolution of the conflict with UN Secretary General Perez de Cullar when I saw him at the recent Namibian Independence celebrations.

Ethiopian Relief

Question Submitted by Chairman Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: According to relief agencies, some 4 million to 5 million people in northern Ethiopia are threatened by famine. The escalation of the war in the north, and particularly the attack on Massawa port by the Ethiopian People's Liberation Front, are endangering plans on the part of international relief agencies to aid the hungry in Ethiopia. What current information do you have on the situation in northern Ethiopia? What plan does the United States have to help assure that the millions threatened by famine are fed? Will it be possible to implement these plans?

A: The war in northern Ethiopia is continuing without let-up. There is fighting along two principal fronts: around Asmara and Keren, the Government's last but strongly held enclave in Eritrea; and, further south, along an axis running from just north of Desse in southern Wello, to lake Gondar (around Bahir Dar and toward Gondar City). More intensified fighting is predicted along both fronts, through which food relief must pass, in coming weeks.

There is little new food currently going into the famine areas of the north. Much of the 150,000 metric tons stockpiled before offensives along the southern and northern fronts during the past two months is unaccounted for, and presumably being distributed somehow. Some limited new distributions are being done by Private Volunteer Organizations. The principal conduit of relief, the port of Massawa, was closed by an EPLF offensive early in February and remains closed. A southern corridor from the port of Assab through Desse and north is being opened with the agreement of the Ethiopian Government and the TPLF. This is key to a UN relief plan worked out in Addis with donor support. The southern corridor will help, but not nearly enough food will flow via this corridor to avert the threat of starvation. There is a food surplus in western Tigray. Some Tigrayans in the famine area are moving there.

Essential requirements are to open up a corridor through Massawa for relief shipments and distributions into Eritrea and Tigray, and to maximize the deliveries and distributions via Port Assab in the south. The southern "Assab" corridor is being opened up now. To prevent starvation and mass movements of people looking for food, however, relief agencies believe it will be necessary to bring Massawa into service. This will probably require that Massawa port be "internationalized" and food deliveries and distribution undertaken/monitored by third parties -- something not yet accepted by either the Government or the EPLF. Yet, this is what we want and are working closely with the Soviets, UN officials and other donors to achieve. Plans are also being developed for receiving refugees in Sudan.

Optimistically, internationalization of the relief effort through Massawa is achievable but probably not in time to stop mass migrations and to save lives. Observers believe the conflicting parties are preparing new offensives to win back or take more ground in the coming weeks. We are arguing against more fighting. We must press forward with our plans and we will, bilaterally, with other donors and the Soviets, and with the UN. Indeed, solutions to relief problems could very well offer a way forward on peace. Nonetheless, we are preparing to work famine relief as well we can around very real prospects for continued fighting.

U.S.-SOVIET COOPERATION IN AFRICA

Question Submitted by Chairman Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: President Gorbachev has often spoken of the importance of resolving regional conflicts. The one great success in regional conflict resolution was realized in southwestern Africa in December 1988, when - under U.S. mediation - Cuba agreed to withdraw from Angola in exchange for independence for Namibia. The Soviet Union lent its support to this accord. What prospects do you see for cooperating with the Soviet Union on resolving other conflicts in Africa, notably the war in Ethiopia and the continuing conflict within Angola? What concrete steps have been taken to enlist Soviet help in ending these wars?

A: I have discussed ways in which the Soviet Union and the United States can faciliate a more positive climate for peace negotiations in Ethiopia and Angola with Foreign Minister Shevardnadze on various occasions.

Indeed, our discussions with the Soviets on peace and relief in Ethiopia -- which began almost two years ago -- have intensified during the past several months. Assistant Secretary Cohen is in frequent contact with his Soviet counterparts about ways in which to jointly foster multilateral donor relief deliveries to the starving in Ethiopia and to influence the warring factions to proceed with peace negotiations. Those exchanges involve talks between the U.S. and USSR and with the Ethiopian government. Recently the US and USSR made a joint demarche to the UN Secretary General about relief and famine in Ethiopia. Prospects are good that this dialogue and cooperation will continue.

At the February meeting with Foreign Minister Shevardnadze in Moscow, we noted in our joint statement that progress toward peace was lagging in Angola and urged the cessation of hostilities and negotiations leading to a political settlement. I followed up on this in my meeting with Shevardnadze during our attendance at Namibian Independence ceremonies. The Soviets played a very constructive role in promoting the negotiations on the Namibian/Angolan settlement. I would hope that they might play a similarly cooperative role in the Angola negotiations.

Soviet Refugees

Question Submitted by Mr. Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Based on the half million applications already picked up in Moscow for Soviets wanting to come to the United States, do you feel that a ceiling of 50,000 per year is realistic?

A. In addition to those Soviets who enter the U.S. as refugees, at least 10,000 more are expected to resettle here in FY-90 as parolees or immigrants. We have significantly increased Soviet refugee admissions, in consultation with Congress, in each of the past two years. Nearly half of our worldwide refugee program is now devoted to the USSR. The introduction of Moscow refugee processing has greatly eased access to our program while more liberal exit permission practices have expanded the pool of potential emigrants. Thus the number of people registering in Moscow has ballooned. Our admissions level represents what the U.S. and private voluntary agencies can realistically be expected to absorb. Moreover, it is consistent with U.S. priorities.

Applications submitted to the Washington Processing Center are vetted to single out persons of special interest to the United States. These include those with close relatives in this country, long-term refuseniks and dissident activists, and members of groups which have suffered especially severe persecution such as evangelical Christians. Potential emigrants who do not fall into the above categories face a wait of years for an interview, if they are ever considered at all. Many such people, however, have alternatives such as emigration to Israel. We have also encouraged other countries to step up their acceptance of Soviet refugees.

Soviet Refugees

Question Submitted by Congressman Obey
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: If we are not going to increase the level of refugees coming to the United States are we going to take steps to assist Soviet Jews who want to go to Israel?

A: We support the right of emigrants to go to any country which offers them resettlement, including Israel. In FY 90 we provided United Israel Appeal, which, in cooperation with the Government of Israel, is responsible for the absorption of immigrants in Israel, with a $25 million grant. In FY 91 the Administration has requested $30 million for U.I.A. for the resettlement of Soviet and other refugees in Israel.

Soviet Refugees

Question Submitted by Mr. Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: If a Soviet citizen were to apply today to come to the United States, the 50,000 ceiling would mean that it would be 7 years before he could be accepted. Are we taking a risk that the "curtain" might come back down in the Soviet Union and people who have indicated that they want to leave will again be stuck?

A. Refugee applications are prioritized based on whether a person falls into a category of special interest to the United States. Priority cases include persons who are long-term refuseniks or activists, those with close relatives in the United States, and members of groups which have suffered especially severe persecution such as evangelical Christians. Someone in one of the identified categories applying today would face a wait of months, but not years, for an interview. Those who do not fit a U.S. priority are encouraged to explore other emigration options. Many of them can immediately qualify to emigrate to Israel.

Soviet Refugees

Question Submitted by Congressman Obey
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: The Israeli Government has asked the United States to provide $400 million in Housing guarantees for new housing for Soviet refugees. They have indicated to me that this housing would not be built in the territories. Since there is no outlay effect of providing the guarantees and it represents a way of assisting people who want to leave the Soviet Union is there any administration opposition to the program?

A: We have expressed our support for proposed housing investment guarantees to help resettle Soviet Jews in Israel, provided the United States and Israel can work out assurances that satisfy the U.S. on settlement activity.

We are not linking or conditioning our aid. We are simply seeking assurances from the Government of Israel on how the guaranteed funds will be spent.

In particular, we feel it is reasonable to ask that housing which our guarantees would support not be located in the territories, and that Soviet Jews will not be encouraged to resettle in the territories.

Should these assurances be provided, we would like the housing guarantee to be in line with standard AID practices pertaining to the management of such guarantees.

Soviet Use of Force in the Baltics

Question Submitted by Mr. Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Has the Administration decided how to respond if a Baltic attempt to secede is suppressed by military force? By non-military means, e.g.: creating arbitrarily insurmountable constitutional obstacles to secession, arresting nationalist leaders, outlawing political organizations advocating overthrow (dissolution) of the Soviet Union, economic blockade, etc.?

A. The Administration has taken every occasion during recent high-level meetings with Soviet officials to convey support for the peaceful efforts by the peoples in the Baltic states to exercise self-determination. The President took the opportunity in his meetings with President Gorbachev in Malta last December to raise this issue. I raised it with Mr. Gorbachev and Mr. Shevardnadze during my meetings in Moscow last February and again, with Mr. Shevardnadze, while in Namibia.

The leadership of the Soviet Union is well aware of our opposition to the repression of non-violent political organizations or of individuals exercising their basic human rights of political expression. As Soviet authorities know, any use of force in such a context against the Baltic states would be abhorrent to the American people and would have highly adverse effects on our bilateral relationship. We are hopeful that the issue can be resolved through dialogue and without repressive actions that would be detrimental to all parties involved.

This Administration has spent a great deal of time and energy to address the fast changing events in the Baltic states. We continue to observe the situation closely. We seek -- through our actions and public statements -- to facilitate conditions in which the Baltic peoples themselves can peacefully resolve their differences with the Soviet Union.

Philippines: Assistance Shortfalls

Question Submitted by Congressman Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Isn't it true, Mr. Secretary, that when Congress completed its work last November on the Foreign Assistance Bill, that funding for the Philippines was not directly cut at all?

--In fact, Congress for the first time in several years chose not to earmark funds for the Philippines in the 1990 bill.

Isn't it true, Mr. Secretary that the Administration in using its discretion in what is referred to as the section 653(a) allocation process decided that the Philippines should not receive full funding of its base rights request?

A: We have had a shortfall of $96 million in FY 1990 ESF and FMF assistance for the Philippines below the Administration's request for a combined total of $360 million. The Administration's decisions on FY 1990 security assistance allocations were constrained by the shortfall in appropriations of approximately $219 million in FMF and $138 million in ESF. These shortfalls were further complicated, despite your efforts, by a high degree of earmarking. This combination of underfunding and a high level of earmarks resulted in zeroing out 13 FMF programs and 14 ESF programs in FY 1990 -- and shortfalls in other critical programs, including the Philippines.

We continue to support full funding for the Philippine program. In keeping with the high priority we place on the Philippines, we are requesting $160 million ESF and $200 million in FMF for FY 1991. We urge the Congress to support full funding for the President's FY 1991 request.

Base Rights

Question Submitted by Representative Obey
House Appropriations Subcommittee on Foreign Operations
3/01/90

Q: Would you comment specificially on whether U.S. foreign aid should be de-linked from base agreements, and what specific path you would recommend regarding U.S. assistance to NATO and non-NATO countries.

A: Despite the perception that U.S. assistance is linked to base rights, the Administration does not consider security assistance to needy friends and allies, such as Greece, Turkey and Portugal, as "rent for bases". On the contrary, U.S. security and economic assistance to these countries is an essential part of our overall defense cooperation with them and serves U.S. interests as well as theirs.

Our military assistance to these countries permits them to carry out needed force modernization programs to meet their NATO commitments and other obligations for the good of the collective defense. Our economic assistance supports their continued economic development, thus enhancing their ability to contribute to the common defense and hastening the day when they can assume a greater share of their own defense burden.

It should also be noted that:

-- In FY 1990, the Congress "earmarked" 91.5% of the total funds appropriated for the Foreign Military Financing Program (FMFP) for 7 countries. Of the 7 earmark recipient states, only 2 - Greece and Turkey - have U.S. bases.

-- Of the 44 designated recipients of Economic Support Fund monies, only 3 - Panama, Phillipines, and Portugal - host U.S. bases.

U.S. Policy Toward South America

Question Submitted by Congressman Obey
House Appropriations Committee
3/1/90

Q: What is your assessment of the status of democracy in South America and whether it can survive in the face of deteriorating living conditions?

A: The 1980s are now commonly referred to as a "no growth" decade in South America and the economic aggregates for the region as a whole are grim. But the issue of economic growth and living standards has become linked to the prospects for democracy in each and every country of South America in virtue of the truly notable fact that all of them now have democratically elected governments. None of us would now be framing the question in quite the same way if over that same decade a great democratic transformation had not taken place.

The great challenge of the 1990s then is to secure the democratic gains of the previous decade by effecting an economic transformation as deep and as embracing as the democratic transformation of the previous 10 years.

Of course, the kind of change needed to turn things around must come from the countries themselves. That is why I am encouraged by the fact that a profound rethinking of economic premises and postulates is underway. Statist and mercantilist models have been discredited by the economic performance of countries which have turned to market-based, outward-looking economic policies (e.g. Chile). Newly elected leaders in South

America (e.g. Menem in Argentina, Collor in Brazil, Rodriguez in Paraguay) are trying to implement such reforms. Countries (e.g. Bolivia, Venezuela, Uruguay) that have already embarked on this course are keeping to it. And, there is a consensus about what is needed that cuts across traditional political divisions. But, of course, the challenge lies in implementation because there are significant costs and real change takes time.

Democratically elected governments -- and that is all the South American governments -- can "deliver the goods." To be sure, governments do not generate wealth; people do. But governments can open up economies, cut unneeded restrictions on the private sector, and create opportunities for growth with benefits that reach to all sectors of society. The same openess and competition that, politically, brought about a democratic revolution can bring on an economic turn-around to realize more fully the promise of democratic change.

U.S. Policy Toward South America

Question Submitted by Congressman Obey
House Appropriations Committee
3/1/90

Q: What is U.S. policy doing to strengthen democracy in South America? Given the shortage of U.S. resources at present, what can the United States do to support these fragile democracies in the face of economic distress?

A: Bilaterally and multilaterally, the United States works with the full array of policy instruments to support democracy in South America. What we do to help the Andean governments combat the traffic in illegal drugs, for example, is -- as it must be -- also supportive of democratic institutions. When we signal our opposition to coups attempts against democratically elected regimes -- especially in concert with other democracies -- we affirm our support for the democratic process.

Countries know that the quality of our relationship with them depends on their support for human rights, whether or not conditionality is written into law. In regional organizations like the OAS, we strongly support the work of the Inter-American Human Rights Commission. Through the Administration of Justice and Democratic Initiatives programs of AID and in cooperation with nongovernmental organizations like the National Endownment for Democracy we are engaged in long-term constructive efforts to support directly the building of democratic processes and institutions.

Your follow on question recognizes that economic stress runs high in many countries and that the people are looking to democracy to improve their living conditions. There is unfortunately no quick fix for the myriad problems that face elected governments -- an easy remedy whose costs we could underwrite. But even within resource constraints, we can help.

Trade makes a dynamic contribution to economic growth. But we must work to ensure that our markets are open to the products of South America. Of course, we are right to insist on access to Latin markets. The benefits of freer trade are not limited to increased Latin exports. Our presence in their markets, whether through our exports or real investments, provides stimulus and know-how to indigenous enterprise and productivity.

Available aid resources have a farther reaching effect if used -- as they are -- to encourage much needed policy reforms. We note too that other industrial democracies have been expanding their roles in South America in the areas of trade, investment, and assistance, and we see that as a natural and positive development.

In the long run, the continuity generated by strengthened democratic processes and institutions contributes to economic development in which all can participate.

U. S. Policy Toward South America

Question submitted by Representative Obey
House Appropriations Subcommittee of Foreign Operations
3/1/90

Q: Is there any danger that the United States may concentrate on Central America as a greater immediate threat, and neglect the greater long-run threat in the much more populous and important South America?

A: In a word, no. Not only are these very different times from just a few years ago, but we are keenly aware that the circumstances are also very different in these two key regions of Latin America. Just a few years ago we considered the Sandinista government in Nicaragua to be a threat to democracy in the hemisphere, particularly to the struggling democratic government of El Salvador, and to the national security of the United States. Now, with the extraordinary results of the February 25 election in Nicaragua and the restoration of democratic rule in Panama, it is clear that the tide has shifted dramatically in favor of democracy, and by extension in favor of U.S. interests in the region. We see the situation in Central America now to be much more one of opportunity than of threat.

At the same time, we are very aware of the challenges and opportunities that face us in our relationship with the larger, more populous and economically much more important nations of

South America. We intend to redress the imbalance that was the unintended result of intense U.S. concern about Central America, and in fact have already made significant strides in that direction. The President's summit meeting in Cartagena with the presidents of Colombia, Bolivia and Peru, at which for the first time in our history we addressed the narcotics threat in a direct, coordinated and multilateral way, is good evidence of this change of focus. With the three concerned governments we are now in the process of building on the agreements and commitments achieved at Cartagena, and I expect solid, quantifiable results in this struggle against narcotics in the very near future.

Obviously, there is still a lot to accomplish in South America. Newly emerging democracies in Paraguay and Chile must be nurtured. The progress that Peru and Bolivia have made in redemocratization, against the odds of tremendous economic problems, also must be sustained. We must work with the courageous new governments of Argentina and Brazil as they attempt to overcome the problems resulting from decades of mistaken economic policies and bad management of resources. And in Colombia, facing the twin threat of narcotics trafficking and leftist insurgency, we must make it clear that we support democratic government's struggle on both fronts, not just on the issue that concerns Americans so immediately, drugs.

Latin American Debt - Brady Plan

Question Submitted by Rep. Obey
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: What is your assessment of the adequacy of the Brady Plan for dealing with the massive foreign debt of South American countries? To what extent have these countries been successful in arranging Brady Plan debt reduction agreements with the commercial banks? What are the lessons to be learned from the Mexican debt reduction agreement? Are any new initiatives contemplated in dealing with the foreign debt of these countries?

A: The strengthened debt strategy provides a positive framework for achieving more manageable debt burdens for a broad range of debtor countries across the globe. The strategy offers heavily indebted countries the prospect of realizing reductions in their debt and debt service obligations to commercial creditors, introducing new incentives and support for implementing and sustaining sound economic policies. The success of the strengthened debt strategy ultimately will be measured as it is implemented, on a case-by-case basis, by the ability of countries benefitting from the plan to sustain economic reforms and realize renewed growth. However, it can be noted that Mexico, Chile, the Philippines, Costa Rica, and now Venezuela, all of which have reached agreements with their commercial creditors under some variation of the Brady Plan, account for 44 percent of the $259 billion in commercial debt owed by the original Baker 15 countries plus Costa Rica.

With respect to South American countries in particular, Venezuela just recently reached an agreement in principle with its bank creditors on a range of options, including a cash buyback of Venezuela's debt, permanent debt and debt service reduction, temporary debt service reduction, and new money. Chile's buyback of commercial bank debt in November 1989 was financed by resources made available under the Brady Plan, and Chile's new government may seek additional arrangements. Uruguay is negotiating with the IMF toward a standby agreement which could serve as the basis for debt/debt service reduction. Ecuador is negotiating with its creditor banks. We also expect that Brazil's new government, which has taken office pledging -- and following through with -- massive economic reforms, will seek to benefit from the strengthened debt strategy. An agreement between Argentina and its creditors will only be possible after that economy stabilizes.

Mexico's breakthrough agreement with its commercial creditors generated well-known debt and debt service reductions benefits for that country, but, perhaps even more importantly, helped to improve the climate of investor confidence critical to the success of any economic program. The relatively long horizon of this package (four years compared to traditional 12-18 month reschedulings) contributes to the stability of Mexico's economic and investment climate, at the same time as it provides financial support in the form of reduced interest payments for Mexico's reform efforts.

The strengthened debt strategy is designed to be flexible in application, and has shown that it can respond to differing needs of specific countries and changing circumstances.

El Salvador: Concluding the War

Question Submitted by Chairman Obey
House Foreign Operations Subcommittee
March 1, 1990

Q: In the absence of a realistic assessment of the war and its prospects for conclusion, how long do you anticipate continuing U.S. military support and at what levels?

A: We believe that a military solution to the Salvadoran conflict by either side is neither desirable nor possible, and that only a negotiated political settlement can end the violence so that necessary democratic and social reforms can be consolidated.

In December in San Isidro, the Central American presidents expressed their support for the elected Salvadoran government and called on the FMLN to cease hostilities, particularly against the civilian population, and to re-enter the political process. The presidents also asked UN Secretary General Perez de Cuellar to help facilitate renewed dialogue between the government and the guerrillas. The Secretary General's personal representative is now meeting with both sides separately in an effort to arrange such a dialogue.

We fully support the negotiating effort that the UN is facilitating, and believe that it holds the promise of a political settlement. Such a settlement would obviate the need for military support at the levels we have been requesting.

El Salvador: Status of the War

Question Submitted by Chairman Obey
House Foreign Operations Subcommittee
March 1, 1990

Q: Where do you see the status of the war in five years?

A: We believe that a military solution to the Salvadoran conflict by either side is neither desirable nor possible, and that only a negotiated political settlement can end the violence so that necessary democratic and social reforms can be consolidated.

We hope that the ongoing UN effort to facilitate a dialogue will lead to a political solution. This political solution would include sufficient guarantees to permit the reintegration of the FMLN and its return to the non-violent democratic process.

El Salvador: FMLN on Negotiations

Question Submitted by Chairman Obey
House Foreign Operations Subcommittee
March 1, 1990

Q: What specific signal are we looking for on the part of the FMLN to enable the beginning of negotiations?

A: The UN is seeking to facilitate negotiations. The U.S. Government is not looking for any signal from the FMLN. We support the UN effort.

The UN effort to facilitate negotiations is predicated on confidentiality. Previous negotiating efforts have been hamstrung by the tendency of both sides, but particularly the FMLN, to conduct a "negotiation by press release." This tactic tends to harden positions and rhetoric and is counterproductive. Since March 13, the FMLN has increasingly resorted to its old tactics of an all-too-public diplomacy. The UN Secretary General has asked on both sides to maintain the confidentiality of the process. We echo Mr. Perez de Cuellar's call.

The FMLN has suspended certain forms of violence, primarily economic sabotage. However, it has reserved the "right" to attack the country's power grid and to kill civilians involved in "military or paramilitary activities." The FMLN's gesture was positive. We hope that the good faith indicated in the statement will be made concrete in deed.

El Salvador: Advice to the Government

Question Submitted by Chairman Obey
House Foreign Operations Subcommittee
March 1, 1990

Q: What are we advising the Salvadorans on this aspect of negotiations?

A: We have reiterated our position that we believe that a military solution to the Salvadoran conflict by either side is neither desirable nor possible, and that only a negotiated political settlement can end the violence so that necessary democratic and social reforms can be consolidated. We have encouraged the government to remain flexible and open to the UN facilitation effort. The government's participation in the UN effort to date has been positive and helpful.

El Salvador: Separating the Security Forces

Question Submitted by Chairman Obey
House Foreign Operations Subcommittee
March 1, 1990

Q: Do you favor separating the Armed Forces from the Treasury Police and National Guard?

A: We believe that ultimately the government would be able to exercise more control over the security forces (the Treasury Police, the National Guard, and the National Police), and the security forces would be more effective, if they were separated from the armed forces (the Army, Navy, and Air Force). However, the principal priority for the armed and security forces now is to deal with the insurgency in an effective and coordinated way, respectful of human rights practices. Certainly, once the conflict ends, we would expect the government to look into this issue, as well as a demilitarization of the region.

Jesuit Investigation

Question Submitted by Mr. Obey
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: How seriously is the El Salvadoran Government investigating the killing of the Jesuits? How does the lax treatment of the prime suspect, Col. Benavides, (i.e., housing in a luxury apartment, apparent freedom of movement, including trips to a beach resort) square with the seriousness of this investigation?

A: We believe that President Cristiani is committed to seeing that justice is served in the Jesuit case and that the actions of the Salvadoran Government to date demonstrate the seriousness of that commitment. Within two months of the crime, a colonel and seven other officers and soldiers were under detention, charged with the murders. The forensic evidence that led to the arrests was developed by the Special Investigative Unit, a Salvadoran Government unit headed by a colonel, staffed by detectives drawn from the security forces and US-trained. The SIU continues its investigation, at the direction of the civilian judge in charge of the case, now concentrating on the possible involvement of other military officers in the planning or cover-up of the killings.

Col. Benavides and the other seven suspects are being kept in separate quarters at the National Police headquarters in San

Salvador, as there are no military prison facilities in El Salvador. The Salvadoran Government has stated that the military prisoners, for security reasons cannot be kept with the general detainee population, which includes FMLN suspects. The Salvadoran military has denied that Col. Benavides was permitted to travel to the beach on a weekend. We have expressed to the Salvadoran Government, at the highest levels, our objection to any preferential treatment Col. Benavides may be afforded.

Nicaragua Assistance

Question Submitted by Congressman Obey
House Appropriations Committee
Subcommittee on Foreign Operations
3/1/90

Q: How much do you anticipate the Administration will request for Nicaragua and where will it come from?

What is the timetable for your request?

A: FY 1990

The Administration quickly put into motion our FY 1990 supplemental request of $300 million for Nicaragua due to the immediate need for these funds and because it was clear that the economic recovery process would have to begin immediately after the Chamorro inauguration on April 25.

The $300 million will be used as follows: $128 million for restoring the productive capacity of the Nicaraguan economy, through support for purchasing agricultural inputs, petroleum and petroleum products, and private sector inputs; $47 million for repatriation of resistance and refugees; $75 million for promoting economic growth and development, initially by providing for emergency employment, medical assistance, technical assistance in the area of economic policy and public management, and other development programs; and a $50 million contribution to a multilateral effort to clear hefty Nicaraguan arrears with international financial institutions, which would pave the way for a Paris Club rescheduling of debt.

The President has requested that this FY 1990 supplemental package, which also includes funds for Panama and for refugee programs, be moved along swiftly in order to be signed into law by April 5.

FY 1991

The effort to reconstruct Nicaragua's economy however must be seen as a longer term effort. The first step is clearly the $300 million FY 1990 package. For FY 1991, the President announced on March 13 plans for a $200 million FY 1991 budget amendment for Nicaragua. As soon as that amendment is transmitted to Congress, we will provide further details on program content.

We anticipate that this package will provide for balance of payments support and facilitate GON efforts to overhaul the nearly bankrupt economy, put into place sound fiscal and monetary policies, privatization and deregulation of economic activity.

In addition, funds will be provided as development support into a number of programs to assist democratic institutions, for agricultural development, private sector reactivation, education, health and population services and support for regional institutions.

NICARAGUA

Question Submitted by Chairman Obey
House Appropriations Committee
Subcommitee on Foreign Operations
March 1, 1990

Q: Do you plan to seek additional aid to the Contras? If so, why in light of the fact that both the Sandinistas and Mrs. Chamorro have called for their disbanding and the fact that the current aid package will adequately feed and cloth the Contras and their families through the end of April?

A: We have submitted a request for $30 million to demobilize, repatriate and reintegrate the Resistance and their families back into civilian life. The funds will be required not to sustain or hold the Resistance together, but to repatriate them.

The additional funds for the Resistance play a vital role in the demobilization process. These funds allow the Resistance members to reintegrate back into Nicaraguan society with the means to sustain themselves during a first few months while they become self-sufficient.

Nicaragua Assistance

Question Submitted by Congressman Obey
House Appropriations Committee
Subcommittee on Foreign Operations
3/1/90

Q: From what specific countries or earmarks would you, Mr. Secretary, take money to provide aid to Nicaragua assuming there were no earmarks?

A: The development resources which the Administration has requested for FY 1991 results from an analysis of individual country needs, coupled with a clear recognition of budget stringencies, as well as overall U.S. national security and foreign policy priorities.

The President will shortly send to Congress a budget amendment for an additional $200 million in FY 1991 for Nicaragua, consistent with the approach the President has taken in 1990. As the President said at his March 13th announcement on Nicaragua, the American people "see a lot at stake for us in a totally democratic hemisphere and the success of democracy in Nicaragua."

NICARAGUA

Questions Submitted by Mr. Obey
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: What is the Administration's view of whether and when the Contras are to disband?

A: The Administration has stated clearly and publicly that it expects the Resistance to return to Nicaragua and to demobilize as soon as it is possible. However, the RN feels that conditions for their demobilization are not yet adequate to meet their legitimate security concerns. The Resistance has stated that it requires adequate security guarantees for themselves and their families within Nicaragua before it can lay down its arms and reintegrate back into society, and the Administration supports this view. Despite the Sandinista's declaration of a ceasefire, they continue to mount offensive operations against the Resistance in Nicaragua. In addition, the recent revelations concerning the treatment of ex-Resistance members who have accepted amnesty to return to Nicaragua (several killed, some missing, and many forced to flee) does not instill confidence that current conditions are sufficient to bring about a rapid mobilization.

NICARAGUA

Question Submitted by Mr. Obey
House Appropriations Committee
Subcommittee on Foreign Operations
March 1, 1990

Q: What is the basis of the Administration's decision to provide humanitarian support to the Contras through April? (for an extra two months) as opposed to the standard procedure of providing funding through March (one month)?

A: In February it had become evident that the CIAV would not be able to assume its role quickly enough to prevent a gap in the delivery of essential human services. In addition, the language of the Bi-Partisan Accords required that the funding obligations be completed by February 28. Accordingly, A.I.D., with the understanding of Congressional oversight committees, obligated funds to provide humanitarian assistance through April.

Afghanistan: Is there a Stalemate?

Question Submitted by Mr. Matthew F. McHugh
House Appropriations Subcommittee on Operations
3/1/90

Q: Is there a stalemate in Afghanistan?

A: A sense of stalemate was created by the fact that the regime did not collapse quickly, as many had predicted. However, the resistance is maintaining military pressure on regime garrisons, including Kabul. At the same time, the Najibullah regime continues to be opposed by most Afghans and suffers from serious factionalism. The recent coup attempt in Kabul not only showed how badly split the regime is; it reminds us that this is not a static situation. While Najibullah retained his position, he will continue to face deep internal divisions in his regime.

Afghanistan: Basis for Negotiated Settlement

Question Submitted by Mr. Matthew F. McHugh
House Appropriations Subcommittee on Operations
3/1/90

Q: Is there a basis for a negotiated settlement at this time?

A: A political settlement can be based on a transition process involving the transfer of power from the Najibullah regime to a representative and independent government. We have coordinated closely on this approach with the resistance as well as with their other supporters. I first discussed a transition process with Foreign Minister Shevardnadze during our meeting in Wyoming in September. The joint statement following our meeting in Moscow in February recognized a need for a transition period providing for an intra-Afghan dialogue, self-determination for the Afghan people and establishment of a broad-based government which would ensure the peaceful, independent and non-aligned status of Afghanistan. However, the Soviets so far have not admitted the necessity for a transfer of power away from the Najibullah regime.

CAMBODIA

Questions submitted by Congressman McHugh
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: What is our role in Cambodia?

A: Our principal efforts on Cambodia are directed to achieving a comprehensive political settlement of that tragic conflict involving a significant role for the United Nations. Because of the inability of the Cambodians themselves to agree on a settlement structure, we have initiated consultations among the five permanent members of the United Nations Security Council (the Soviet Union, China, Great Britain, France and ourselves) to attempt to forge a consensus on elements of a settlement which could then be recommended to the Cambodian factions.

While many difficult issues remain to be resolved, the first three Perm Five sessions have made considerable progress in outlining the role the United Nations would play in a settlement arrangement, including peacekeeping operations and direct administration of elections. We hope that these efforts and those of the regional states, particularly the ASEAN countries, will permit an early resumption of the Paris Conference on Cambodia, resulting in an agreement that will bring lasting peace to the Cambodian people.

Q: Why does the U.S. persist in supporting a role for the Khmer Rouge?

A: The U.S. position on the Khmer Rouge has been clear and unambiguous: we prefer that the KR have no role whatsoever in any Cambodian regime. We have also made clear that one of our major prerequisites for a Cambodian settlement is that it provide concrete measures to assure that this murderous group cannot return to power. Finally, we have said that our ability to support any Cambodian government is inversely related to the degree of Khmer Rouge participation, if any, in it.

Aid to Pakistan

Question Submitted by Congressman Wilson
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Mr. Secretary, the Administration's ESF request for Pakistan for FY 91 is $210 million, which represents an approximate $20 million cut from the FY 90 appropriation and fully $40 million under last year's Administration request. Since Pakistan is a strategically vital ally, a new and thriving democracy, and is selflessly providing for almost four million Afghan refugees living on its soil, how can we justify this reduction in U.S. economic assistance? I recognize we have new needs arising in Eastern Europe, but those needs do not lessen the situation faced by Pakistan.

A. The Administration's decisions on the FY 91 request for ESF were constrained by the budget ceiling. The ceiling did not allow us to request above a bare minimum for many critical programs. We do believe that the request represents a balanced approach that takes into account country needs, U.S. national security and foreign policy objectives, and the constrained budget situation.

In the case of Pakistan, the Administration requested a total program of $578 million in economic, military and counter-narcotics assistance. Pakistan remains among the top five recipients of U.S. assistance. We believe Pakistan merits our continued assistance as a new democracy struggling to build democratic institutions, as a developing country with a per capita income of less than $400 per year, as a friend in a strategically important part of the world, and as a partner in the war against narcotics. For these reasons, we will continue to request substantial assistance for Pakistan.

Global Climate Change

Question submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q. What steps are you taking to convince the President and other senior Administration officials of the need for immediate action that you described a year ago?

A. In my speech of January 1989, I stated that while scientists refine the state of the knowledge on climate change, the global community should focus immediately on prudent steps that are already justified on grounds other than climate change, including reducing CFC emissions, greater energy efficiency and reforestation. The President, in his speech to the IPCC in February 1990, made these same points, stating that the United States is intensifying research into the scientific and economic aspects of climate change while implementing immediately measures which are justified on their own merits. To this end, the Administration has:

- proposed $1 billion in FY 1991 funding for global change research, an increase of 57 percent over FY 1990 levels;

- intensified research on the economic costs of implementing measures to reduce greenhouse gas emissions;

- proposed revisions to the Clean Air Act which should enhance air quality and reduce greenhouse gas emissions;
- advocated a phase-out of CFCs by the year 2000;
- launched a major reforestation initiative to plant a billion trees a year on private land across the country; and
- emphasized initiatives to increase energy efficiency and the use of renewable sources as part of the comprehensive review and revision of the National Energy Strategy.

Global Climate Change

Question submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q. What steps are you taking personally to ensure that negotiations on a convention proceed as rapidly as possible and focus on setting strict global goals for reductions in global greenhouse emissions?

A. We expect negotiations on a framework convention on climate change to begin soon after the completion of the IPCC first assessment report in August 1990. The President recently offered the United States as the venue for the first round of talks. The Department of State is consulting actively with WMO and UNEP, the UN bodies charged with preparing for these negotiations, regarding the timing and structure of these meetings.

Our position concerning global goals for reductions in global greenhouse emissions is that, as with the Vienna Convention and the Montreal Protocol, a two-pronged approach is most effective. The framework climate convention should enunciate principles for cooperation in research, monitoring, and enhanced understanding of the issue, with targets and timetables to be addressed separately. The process of negotiating the framework principles can help to catalyze the informed international consensus needed for adopting specific action measures.

Global Climate Change

Question submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q. What specific steps is the State Department taking to prepare for these negotiations, and who will you appoint to lead the U.S. negotiating team?

A. The United States chairs the Response Strategies Working Group of the Intergovernmental Panel on Climate Change (IPCC), which is carrying out the mandate of the IPCC to develop possible elements of a climate convention to serve as a basis for negotiations. We expect the negotiations to begin following completion of the IPCC report in August. Formal responsibility for preparing for negotiations rests with the UNEP and WMO. The President has offered the United States as the venue for the first round of these negotiations. Although WMO and UNEP have made no formal decision on this offer, the initial response by the international community has been favorable, and the State Department is coordinating with WMO and UNEP in preparing for negotiations. The U.S. delegation to the negotiations will be named after such specifics as the timing and the level of representation have been worked out.

EASTERN EUROPE

Question submitted by Congressman Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: As the State Department has taken a major role in coordinating substantially increased flows of technical and financial assistance to the nations of Eastern Europe, what mechanism for planning and coordination has the Department established to ensure that all federal agencies operating in Eastern Europe have as a primary goal of their programs environmental restoration, protection and enhancement?

A: The SEED Act calls upon the President to designate a SEED Program coordinator within the Department of State. By executive order the President designated the Department's Deputy Secretary Eagleburger as coordinator, with day-to-day activity coordinated by Ambassador Robert L. Barry. The coordinating council is composed of over 20 federal agencies, including EPA, DOE and AID. Council review guarantees that environmental concerns are addressed from a number of perspectives. This multi-dimensional review process ensures that environmental issues are fully covered.

EASTERN EUROPE

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: What specific steps are you taking to ensure that all private-sector joint ventures funded by federal agencies meet environmental standards no less stringent than those applied in this country?

A: We will require appropriate environmental safeguards as a condition for U.S. funding for joint venture projects. However, ultimately, every nation will insist on setting its own environmental standards.

EASTERN EUROPE

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: What specifically are you doing, in cooperation with AID, to help these Eastern European countries develop strong programs, policies and institutions for environmental protection and restoration?

A: The SEED Act calls upon the President to institute a coordinating council which is chaired by the Department, to coordinate federal activity involving assistance to Eastern Europe. We cooperate closely with AID and EPA in developing the programs for the Regional Environmental Center to be located in Budapest. In addition, we have programs with the Polish Ministry of Health to establish an air quality monitoring system and to improve water quality in Krakow, Poland. We also have bilateral science and technology cooperation agreements, administered by the Department in cooperation with a broad range of U.S. technical agencies, which support joint research on environmental and related questions.

EASTERN EUROPE

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: What specific steps are you taking to ensure that U.S. funded "enterprise funds" in these nations establish and implement strict environmental standards for all projects, particularly joint venture projects involving U.S. entities?

A: We will work with the management of these funds to ensure that appropriate environmental safeguards are incorporated into their lending guidelines.

OZONE DEPLETING CHEMICALS

Question submitted by Congressman Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: What steps has the State Department taken in identifying and proposing a mechanism for special assistance to these developing countries?

A: The State Department, in consultation with other concerned agencies, is currently developing its position on a mechanism for special assistance to developing countries to facilitate their shift to substitutes for ozone depleting products, in preparation for discussions and decisions to be taken at the Second Meeting of Parties to the Montreal Protocol to be held in June 1990.

From February 26 - March 5, 1990, a working group meeting was held in Geneva devoted to the issue of assistance to developing countries ("Article 5 countries"). Participants included both Parties and non-Parties (e.g., India and China) to the Montreal Protocol. The group identified three needs: a) a coordinating committee of the parties to oversee the provision of assistance to Article 5 countries; b) a clearinghouse to facilitate national assessments of needs, assist in the transfer of relevant technologies, and maintain an inventory of proposed projects; and c) a fund to finance agreed incremental costs of acquiring substitute technologies and products in connection with the shift away from CFCs. EPA has agreed to contribute to the costs of establishing a clearinghouse facility under UNEP or other suitable auspices. The World Bank is prepared to work with the Parties as the manager of the Fund element. Participation by the United States in a funding mechanism will be on a voluntary basis.

OZONE DEPLETING CHEMICALS

Question submitted by Congressman Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: Has State calculated the magnitude of foreign aid which will be required to achieve the goals of the Montreal Protocol?

A: Our very preliminary cost estimate for funding a mechanism to cover incremental costs for the initial three year period of operation of a funding mechanism under the Protocol indicates that total capital costs could be around $100 million for the current Article 5 countries. UNEP officials estimate that an additional $100 to $200 million might be needed if China, India and others joined at the beginning of that period. They also estimate a need for $18 to $20 million during those years for the clearing house, technical assistance and coordination functions. Reliable estimates beyond that period are difficult to make, although requirements may well be higher as new technologies come on stream and the need arises to introduce them into LDCs.

United Nations Environment Program

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Can you convince this Committee that the Administration is serious about its commitment to environmental protection when the Administration's proposed FY 91 budget for UNEP is $2 million less than what this Committee appropriated last year, especially in light of the fact that this comes at a time when UNEP is being required to deal with increasingly complex issues such as global climate change, ozone depletion and other international environmental issues?

A. The Administration's Fiscal Year 1991 request for $10 million for UNEP constitutes an increase of 25 percent over the amount requested for FY 1990. This reflects full awareness of and appreciation for the important and growing role of UNEP in worldwide environmental affairs. The United States has strongly supported UNEP from its inception, and has consistently maintained its standing as the largest contributor to the Environment Fund. While we expect this situation to continue, we would encourage all members of UNEP to increase substantially their donations to the Fund, in line with the decision of the fifteenth session of UNEP's Governing Council to seek a total of $100 million in annual contributions by 1992.

United Nations Environment Program

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Why did the Administration propose a 17 percent decrease for the U.S. contribution to UNEP for FY 91?

A. The Administration's Fiscal Year 1991 request for $10 million for UNEP constitutes an increase of 25 percent over the amount requested for FY 1990. This reflects full awareness of and appreciation for the important and growing role of UNEP in worldwide environmental affairs. The United States has strongly supported UNEP from its inception, and has consistently maintained its standing as the largest contributor to the Environment Fund. While we expect this situation to continue, we would encourage all members of UNEP to increase substantially their donations to the Fund, in line with the decision of the fifteenth session of UNEP's Governing Council to seek a total of $100 million in annual contributions by 1992.

The IPCC

Question submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q. Explain how the $100,000 for the IPCC will be used, and explain what this group has accomplished so far. Please also provide a timetable for upcoming IPCC meetings and a schedule for reporting on all three working groups.

A. The $100,000 for the Intergovernmental Panel on Climate Change (IPCC) will go to the IPCC Trust Fund, which funds Secretariat support for IPCC meetings and participation in IPCC meetings by representatives of developing countries. As a global forum to address a global issue, participation by a full range of countries is crucial for the IPCC's effectiveness and credibility. The report of the IPCC is intended to represent an international consensus. Without the trust fund, many developing countries would not be able to take part in the IPCC process. At the Third IPCC Plenary, the IPCC Trust Fund made possible attendance of delegates from over 30 developing countries.

The IPCC was established in June 1988. The goal of the IPCC is to assess our understanding of the science and likely impacts of climate change and to consider possible response strategies for limiting and adapting to climate change. This work is being conducted by three IPCC Working Groups chaired by the United Kingdom, the U.S.S.R., and the United States, respectively. Each working group, in turn, is examining various aspects, as shown below.

The first assessment report is scheduled to be adopted at the IPCC's fourth plenary session in Sundsvall, Sweden in late August of this year. The IPCC's assessments of climate change science and impacts will represent the first major comprehensive statements on these issues by the international scientific community, and the IPCC's work on possible response strategies will provide a set of options for governments to consider for limiting and adapting to climate change. The IPCC report will also contain an analysis of possible elements of a framework convention on climate change.

Numerous meetings of various subgroups of the IPCC are scheduled for the spring and summer of this year, culminating in the Fourth Plenary of the IPCC in late August. A schedule of the remaining meetings of the IPCC is attached. The First Assessment Report will be released to the public after its approval at the end of August.

Schedule of IPCC Meetings

April 5-6: Special Committee on Developing Country Participation, Designated Drafting Group, Paris (dates to be confirmed)

April 23-25: IPCC Working Group III, Subgroup on Resource Use Management, Geneva

April 26-27: IPCC Working Group III, Subgroup on Agriculture and Forestry, Geneva

May 1-3: IPCC Working Group III, Subgroup on Coastal Zone Management, Final Drafting Session, The Hague (venue to be confirmed)

May 23-25: IPCC Working Group I, approval of WGI report on Science, Windsor, UK

May 28-31: IPCC Working Group II, approval of WGII report on Impacts, Moscow

May 31-June 1: Third Meeting of the IPCC Special Committee on Developing Country Participation, Geneva

June 5-8: IPCC Working Group III, approval of WGIII report on Response Strategies, Geneva

June 18-20: IPCC Designated Report Drafting Committee, Geneva

August 27-30: IPCC Fourth Plenary, Approval of First Assessment Report, Sundsvall, Sweden

Topics being examined by the IPCC

Science Working Group (WGI)

- recent measurements of greenhouse gases and the new information on their chemistry and tropospheric lifetimes
- a critical review of available climate data for detecting trends
- evaluations of existing disagreements in model calculations of regional scale climate change
- transient climate change calculations
- new evaluations of sea level rise
- future requirements for climate research and observing systems for monitoring climate change

Impacts Working Group (WGII)

- permafrost
- ecological processes
- human settlements
- water resources
- natural terrestrial ecosystems
- world oceans and coastal zones
- forests
- agriculture and land use

Response Strategies Working Group WGIII

- Emission Scenarios
- Sector analyses:
  - Energy and Industry
  - Agriculture, Forestry, and Other Human Activities
  - Coastal Zone Management
  - Resource Use and Management

Response Strategies Working Group WGIII (cont.)

o Implementation mechanisms:

  - Legal and institutional mechanisms, including elements of a framework convention

  - Technology development and transfer mechanisms

  - Financial mechanisms

  - Public education and information

  - Economic and market mechanisms

Afghanistan: Resistance Military Victory

Question Submitted by Mr. Porter
House Appropriations Subcommittee on Operations
3/1/90

Q: Mr. Secretary, with the recent talks between ourselves, the Soviets and the Pakistanis, have we completely given up on the possibility of a military victory for the resistance forces in Afghanistan?

A: We remain confident that the Afghan resistance will achieve its goal of independence and self-determination for Afghanistan. We understand that the resistance's current strategy is aimed at keeping sufficient pressure on the regime so that it will become clear that a political solution is necessary. This would involve the departure of the Najibullah regime and installation of a representative government through a transition process.

Suspension of Food Aid to Afghan Resistance

Question Submitted by Mr. Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: It is my understanding that we have cut off all food aid to the Mujahidin. Is that true and when will shipments resume?

A: We temporarily suspended food shipments -- representing approximately 30% of our total humanitarian assistance for war affected Afghans inside Afghanistan -- in late November. This was done as a result of difficulties encountered in meeting our statutory and regulatory requirements in allocating and monitoring of those shipments.

Food shipments were resumed briefly in January, but were suspended again until satisfactory monitoring arrangements are put in place. The U.S. Mission is working closely with Pakistani and Afghan Interim Government officials towards those objectives. We expect that these arrangements will be completed soon, and food shipments will be resumed as soon as possible.

EASTERN EUROPE

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
March 1, 1990

Q: I noticed in your proposed aid package for Eastern Europe you included $30 million to respond to their horrendous environmental problems. Given your recent travels there, what are the pressing needs that you see, and how can the U.S. use our special talents to respond?

A: Eastern Europe needs to address regional environmental problems, and associated health problems, across the board. This involves a difficult exercise in setting priorities among a host of pressing needs. The U.S. experience in environmental management--positive and negative--can be of assistance in this regard. The SEED program provides a mechanism through which a number of these priorities can be addressed: wasteful use of energy and other natural resources; industrial reconfiguration to generate less pollution; application of market incentives in environmental management; responsible public participation in environmental policy formulation; improved capabilities to assess and manage environmental health risk; training a new generation of environmental scientists, engineers, and managers. In short, it elaborates a vision of sustainable development specifically tailored for Eastern Europe.

Family Planning

Question Submitted by Representative Porter
House Appropriations Subcommittee on Foreign Operations
3/1/90

Q: Mr. Secretary, we have disagreed on the need for refunding UNFPA before and I do not intend to rehash those arguments now. I think we all can agree on the following points:

a. Rapid population growth lowers average income (China, India, Kenya).
b. Population growth is probably the number one engine of environmental destruction (Brazil, Indonesia, Africa).
c. Voluntary Family Planning is a key part of our response to these long term threats.
d. The American people including a strong majority of Republican voters support voluntary family planning
e. Continued American support of voluntary family planning is essential to the long-term economic and environmental future of many Third World nations.

In this context, I hope that we can agree that support for voluntary family planning is not only essential and possible but also popular with the American people.

Your response?

A: The Administration, as evidenced by important A.I.D. programs, supports voluntary family planning programs which do not condone or encourage abortion or coercive measures.

Since 1965, A.I.D. has obligated $3.9 billion for population activities of which $2.3 billion, 65 percent, was obligated since 1981. A.I.D. accounts for 45 percent of international population funds, the largest source by far.

A.I.D. estimates that approximately $247 million will be allocated in 1991 to voluntary family planning activities through regular development assistance, the Development Fund for Africa, and economic support funds.

Examples of programmatic leadership include:

-- A.I.D. supports population activities in 95 countries of which 45 are in sub-Saharan Africa where A.I.D. has been at the forefront in establishing family planning programs.

-- A.I.D. is the source of 75 percent of donor-provided contraceptives for the developing world.

-- A.I.D. has trained some 150,000 family planning service providers in 120 countries, two-thirds of them since 1981.

-- A.I.D. supports the world's largest survey research effort in the developing world, the Demographic and Health Survey. Results from 139 surveys in 65 countries have revolutionized our understanding of population dynamics.

-- In 1988, for instance, over 30 million couples used family planning as a direct result of A.I.D.'s program. In the 20 largest recipient countries of A.I.D. population funds, the average number of children per family has dropped from 6.1 in the 1960s to 4.5 today, a 26 percent decline.

WEDNESDAY, MARCH 14, 1990.

DEPARTMENT OF THE TREASURY

WITNESSES

HON. NICHOLAS F. BRADY, SECRETARY OF THE TREASURY

CHARLES H. DALLARA ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

CHAIRMAN'S OPENING STATEMENT

Mr. OBEY. Good morning. This morning we will hear from the Secretary of the Treasury, Mr. Nicholas Brady, on the Administration's supplemental budget request for 1990 and for the regular annual request for 1991.

Last year the Administration requested $1.787 billion for the international financial institutions. Congress provided about $179 million less, a total of $1.608 billion. This year the Administration's request is about $40 million less than last year's request, but it is about $140 million more than the Congress provided.

Additionally, we have a supplemental budget request for callable capital for the World Bank totaling $1.6 billion. We are talking about a fair amount of money this morning.

Mr. Secretary, we meet in rapidly changing times. The committee certainly wants to see our reactions to those times fit the needs of the day. We at least are significantly concerned about the context in which some of these changes are taking place, especially the impact of some of these changes on our ability to deal four-squarely with the mounting debt situation around the world.

As you know, last year the committee declined to provide the callable capital for the World Bank, not because we were unhappy with the Administration, but because we felt the commercial banking sector of this country was not giving sufficient cooperation to the Administration. As long as that cooperation was not forthcoming, the Brady Plan could not succeed in actually dealing with the realities of the third world debt situation. We felt as long as we could not realistically deal with that problem, we faced not only the potential for continued political instability in debtor nations, but also continue to face a situation in which other sectors of our own economy are systematically denied opportunities for expanded commerce with that region of the world. The result is an attendant loss of business and loss of jobs in the manufacturing and export section of our economy, not to mention the problems that are also caused for our agricultural economy.

I am sure the committee will want to get into those issues with you this morning. I will also, frankly, want to explore with you your own views about something which might not appear directly related to this committee—the Rostenkowski plan which was raised over the weekend. It is relevant because it does set the context in which foreign assistance requests are discussed.

However, before I do that, I would simply like to get a housekeeping matter out of the way. We have a problem in this committee. I frankly have not read your testimony yet this morning. The reason I did not read it is because it was not delivered by Treasury to the Hill until after I left last evening.

The problem is that we cannot give you the courtesy of reading your testimony if Treasury does not give us the courtesy of delivering it in compliance with the committee rules. We have a two-day notice. We try not to be sticklers about it. However, it does cause us a problem, especially when we have not received a number of other items of information from Treasury which we need to do our jobs. We want to decide the responsible course to take with respect to actions requested of this committee in funding the international financial institutions. Our actions are tied very closely to the entire debt situation worldwide.

We have asked for a number of reports which were due and have not yet been provided to this committee. We simply do not have the information we need to ask the right kind of questions this morning.

I will give you some examples. Mr. Roybal and Mr. Alexander requested a Paris Club report due by February 1st. We do not have that. This committee requested a debt receipts report. We want to know which foreign countries are paying us back and how much they are actually paying. We are trying to get an accurate picture through Treasury's eyes of the amount of capital reflows are to the United States.

We have asked Treasury to prepare a plan for a centralized debt and credit system so that we do not have to run to fifty different places to find out what is happening with respect to the debt situation.

The government itself does not know at this point, in my judgment, who is doing what in terms of debt. We do not have a centralized information collection area where we can gather and interpret all the data for management or policy purposes.

Mr. Gray, the former Chairman of the Budget Committee and a member of this subcommittee, also had asked the Treasury for a report on Caribbean debt. Although there is no due date on this, so Treasury is in compliance, we need the information as soon as possible.

We want to be as cooperative as possible with you. But our job is very difficult when we are not given the information from the Administration we need. So I am going to ask you when we get these reports? We really do need that information before we can move on any supplemental. Since the President asked us yesterday to move rapidly, it would be nice if the Administration would cooperate so that we can.

Having said that, let me welcome you. Let me ask Mr. Edwards if he has anything he would like to say before we begin.

MR. EDWARD'S OPENING STATEMENT

Mr. EDWARDS. Thank you, Mr. Chairman.

Nick, it is good to see you again. Glad to have you back with us. I have a few comments I would like to make before we get your testimony.

Mr. Secretary, as we all know, the entire world is at a crossroads. We face a unique challenge in Eastern Europe and in parts of Central America, while at the same time many of the nations in Latin America and Africa are saddled with debt which I am afraid some of them may never be able to repay.

We have a unique opportunity now in the United States to help permanently remove communism from the face of Europe, and as the leader of the free world and as the role model which so many of those nations are following, we have an obligation to see that those nations do not slip back toward communism.

How do we accomplish that? We have gone quite a few years now without any major changes in our foreign aid programs. Any changes in the world have been expected to fit into our existing foreign aid accounts rather than us reshaping our foreign aid accounts to meet these global challenges.

It is my opinion that that is no longer possible. The unprecedented changes that are occurring in Eastern Europe and elsewhere must be met with equally innovative types of assistance.

We must tear down our existing foreign aid program and build a new one from the foundation up. There are currently too many conflicting priorities within our foreign aid budget. There is no way to truly determine whether the sale of military equipment or disaster assistance or a World Bank project in Asia is most important to our national interest, and yet they are all competing with each other for scarce foreign aid dollars.

It may be that the only sensible way to restructure foreign aid is to separate our security assistance programs from our development and humanitarian programs. Perhaps aid to base rights countries and military assistance to our closest allies should be taken out of this bill and placed within the budget of the Department of Defense.

In that way, a rational determination about whether or not one country should receive more aid than another would be made on its merits, rather than pitting one type of program against another which has completely different goals. Maybe we should stop trying to mix apples with oranges in foreign aid, and, as we all know, we do that in the hopes that one part will carry another part when we get to the House floor.

Within our economic and development programs, I think we have to better prioritize our aid. In our hearings in this committee, it is apparent that there is no consensus to increase the size of the foreign aid budget. The American taxpayer simply will not stand for it. Moreover, it is not necessary.

I have never been a fan, as you know, of multilateral institutions. Scarce U.S. dollars could be better spent on direct bilateral aid to our closest friends and to those truly in need. It does the United States no good to aid through multilaterals nations which do not support and often actively oppose U.S. policies.

I believe that U.S. contributions to existing multilateral banks should be reduced and the money should be redirected to our own programs, whether AID, the Export-Import Bank, or the Trade and Development Program, or others.

Furthermore, the extent of U.S. participation in a new multilateral bank to help rebuild Eastern Europe should be carefully considered. Those fledgling democracies need help building democratic institutions and developing private sector economies. There is no nation on earth that rivals the United States in either of those categories, and there is no reason that the United States cannot help those nations on a bilateral basis.

The last thing that we want to see is an Eastern Europe that, instead of struggling under the yoke of communism, is struggling under the yoke of a crushing debt to multilateral banks.

I look forward to hearing your testimony, Mr. Secretary.

MR. BRADY'S COMMENTS

Secretary **Brady**. Thank you, Mr. Chairman. Let me just make two comments.

First, about your comments on the fact that some of our reports are late in coming and that the testimony did not get here in time for you to have a good look at it. I think that is a valid complaint. We too were working late last night, into last night, on the oral testimony I will give you this morning. It was no attempt on our part not to get the written testimony up here on time; simply the press of business did not allow us to get it here much quicker. We will try to do better in the future.

Certainly, with regard to these reports that you mentioned, we will get them here forthwith. I would say that some of these reports are not just reports out of the Treasury, so we have the added problem of getting cross-agency cooperation, and that always adds more time than you hope it would.

The only comment I would—I know you understand, but I would mention in rejoinder—that I have three testimonies next week, Tuesday, Wednesday, and Thursday. Because so many of the key parts of our foreign policy and national security arrangements relate to the economic sector, the requests on the Treasury Department to provide adequate information have doubled or tripled. That is no excuse not to get it here, but it is a factor in why it was not here on time.

I know of your feeling about this matter and I simply say that I am sorry we did not get it here ahead of time.

With regard to Congressman Edwards' opening statement, I would agree that one of the things we are going to have to strive for in the next year, as soon as possible, is some better definition of what our national security really is. As the world moves to more peaceful changes of borders or at least certification of borders through peaceful means rather than the use of armies and weapons, it is clear that the term "national security" involves a lot more than just weapons and guns.

As we strive for that definition, it is important that we realize that the economic side of life provides a very big part of that, and to do that we have got to have some new definition in mind of what national security really is.

I would quarrel with the second part of what the Congressman has said, in the sense that I believe we get more bang for the buck out of multilateral aid than we do out of bilateral aid, and particularly in stringent budget times in the United States. So that is a point that we should discuss some more.

If I may go into my opening statement, Mr. Chairman, which is greatly foreshortened, and ask that my complete statement be incorporated into the record.

Mr. **Obey**. Sure.

MR. BRADY'S OPENING STATEMENT

Secretary **Brady**. It is a pleasure to meet with you today to discuss the Administration's fiscal 1990 budget proposals for the MDBs and the International Monetary Fund's Enhanced Structural Adjustment Facility, and to review progress in implementing the strengthened debt strategy.

I would like to insert my longer testimony, as I mentioned, for the record.

Since my appearance before you last year, the world has been transformed. Eastern Europe has undergone changes far beyond what could realistically be expected in so short a time span. Closer to home, countries in South and Central America are trying to move towards democracy and better economic policy.

These events amply demonstrate the soundness of principles the United States has long advocated: pluralistic, democratic political processes and a general reliance on the market to allocate resources. But these events, which certainly mark a sea change in global affairs, do not occasion self-congratulation so much as a call for deep reflection as to how to proceed from here.

INTERNATIONAL FINANCIAL INSTITUTIONS

The changes toward democracy mean that promoting U.S. national interests will rely more on promoting sound economic policies than upon military strength. Therefore, it is essential that the United States maintain an active leadership role in the international financial institutions which will have a prominent role in Eastern Europe and Central America.

I know, Mr. Chairman, you realize fully the United States' long-term self-interest in nurturing these institutions. I want to acknowledge and thank you and members of your committee for the support you have demonstrated for these institutions.

For fiscal 1991, the Administration is requesting $1.7 billion in budget authority and $6.8 billion under program limitations for the MDBs. Of this $1.7 billion, $268 million stems from shortfalls from previous requests and $1.5 billion is to honor previously agreed payment schedules.

It is worth emphasizing that the request, which seeks funding for ongoing programs, a new replenishment of resources for IDA, and all U.S. MDB funding shortfalls, has the full backing and support of the President.

Mr. Chairman, the United States should make these payments in full, including all arrears, this year. The MDBs are now lending funds at a rate of about $30 billion annually. U.S. financial support has averaged about $1.4 billion in recent years. This means U.S. dollars are multiplied over 21 times—21 times—through the intermediation of private capital markets, retained earnings, repayments on earlier loans, and contributions of other donors.

However, U.S. financial support of the MDBs does more than leverage U.S. dollars to promote growth in developing countries and advance U.S. humanitarian concerns. It leverages U.S. international leadership.

Our ability to exercise international leadership on such issues as developing country debt burdens and protection of the environment have been aided immensely by our standing in the international financial institutions. No doubt, our standing in these institutions is a function of the power of the ideas we put forward and our financial support. But we should not delude ourselves: ideas and financial support must move in tandem to be effective.

DEBT STRATEGY

The international financial institutions clearly serve a broad range of U.S. interests, but I want to focus particular attention on the contribution these institutions make through their support of the debt strategy. A year ago I testified before this committee on the outlines of a new approach to developing country debt problems. As I was a year ago, I am confident that our approach provides a solid basis for progress in addressing these problems.

This year, however, I can cite evidence to confirm that this strategy, through reduced commercial debt burdens and economic reform, can help countries improve their investment climate, bring capital home, and boost foreign investment, revive economic growth and build the potential in these countries as active participants in a vibrant world economy.

Mexico is experiencing real benefits from the agreement it signed with commercial banks on February 4th. In Mexico's case, interest payments to commercial banks will be reduced by one-third, or $1.5 billion a year. $42 billion of debt payments will be forever removed from the shoulders of the Mexican people. Domestic interest rates have fallen significantly, resulting in savings equivalent to four to five percent of GDP. And net private capital inflows of $3 billion in 1989 indicate that flight capital is returning home and investor interest is reviving.

Ninety-nine percent of the 450 banks with exposure in Mexico chose to participate in this package, leaving no free riders to detract from the package. As a result, Mexico is on the move again and has high expectations about its economic future.

The agreement between the Philippines and its commercial banks places greater emphasis on new money and direct cash buybacks. Benefits include: annual savings of $120 million, or 20 percent of scheduled payments on medium-term commercial bank debt; and satisfaction of projected financing needs for 1989-90, while achieving net debt reduction of 10 percent.

Some observers have raised questions about whether the benefits of this package are really significant. In fact, the Philippine agreement helps demonstrate the flexibility of the strengthened debt strategy and its potential to meet the needs of diverse countries and diverse country interests.

The Philippines' situation varies significantly from that of Mexico. Its financing needs are much higher relative to its commercial bank debt outstanding. Its commercial bank debt burden is not as heavy. A Mexico-style package would have covered only half of the Philippines' projected financing needs for the current year 1990.

Implementation of Costa Rica's commercial bank agreements is also expected to produce results. Costa Rica's stock of debt will be reduced about 60 percent. Annual interest rates will be reduced by 60 percent for 20 to 25 years. Such measures will leave Costa Rica with a debt service burden which reflects more realistically its ability to pay.

Although these three agreements have received the most attention over the last year, debt reduction agreements can be pursued by any country with medium-term commercial bank debt and a strong commitment to economic reform.

Chile has made use of the new debt strategy through a limited direct buyback, marking the latest stage of an ongoing debt reduction program which since 1985 has enabled Chile to retire $7.8 billion in debt.

Other countries are moving to seek similar arrangements with their commercial creditors. Venezuela is near agreement with its banks. Morocco has been discussing a package on an ongoing basis. Potential future candidates include Bolivia, Nigeria, Ecuador,, Uruguay, and, following a leadership transition, Brazil.

Continuing our efforts to promote economic reform and sustain growth depends fundamentally on the international financial institutions. In addition to continuing their project and policy-based lending over the last year, the IMF and World Bank have begun to provide special financial support to make commercial bank debt and debt service reduction possible.

In short, the agreements negotiated between debtor countries and their commercial banks could not have taken place without the IMF and the World Bank. As advisers and catalysts, these institutions are our fundamental tool for bringing about serious economic reforms and significant reductions in commercial bank debt burdens.

ENVIRONMENTAL CONCERNS IN THE MULTILATERAL DEVELOPMENT BANKS

Let me now, Mr. Chairman, turn to environmental issues in the multilateral development banks, an area in which we have received a substantial mandate from Congress to press on for wide-ranging reforms over the past several years. At last count we have had 35 separate legislative provisions encouraging us to promote more rapid progress toward environmental objectives, including environmental impact assessments, promotion of energy efficiency and conservation measures, and greater protection of the natural resource base, particularly tropical moist forests.

Clearly, our most significant accomplishment over the past year has been inclusion of the more stringent environmental provisions in the agreement for replenishment of IDA. They include implementation of environmental impact assessment procedures, increased public access to environmental information to promote more participation by local community groups, closer collaboration and cooperation of non-governmental organizations in borrowing countries, greater emphasis on energy efficiency and conservation in borrowing countries, more support for debt-for-nature swaps, and more rapid progress on environmental action plans.

We are pleased with the progress achieved thus far. At the same time, there is still much to do. In particular, we will have to increase our efforts to assure that the agreements we have reached are implemented effectively and that loans of doubtful quality are not brought to the board.

For example, last year we stopped a major power loan that would have had far-reaching negative effects on the tropical forests in Latin America. Now we are increasingly concerned about forestry projects in other regions, including those that are part of the tropical forestry action plan, seeking to have greater emphasis placed on protection and preservation measures.

We have encouraged the World Bank to adopt standards for evaluating projects that may adversely affect tropical forests and we are hopeful that it will do so later this year.

INTERNATIONAL DEVELOPMENT ASSOCIATION

Turning to the International Development Association, in addition to the finance provided through the MDB capital loan windows, it is critical to provide special support for the low-income developing countries through this vehicle.

In December '89 negotiations were completed for the ninth replenishment of IDA resources. We are requesting authorization for a U.S. contribution to IDA-9 of $3.2 billion or $1.1 billion annually for three years, maintaining our contribution in real terms from IDA-8. Thus, the U.S. contribution would increase by $102 million a year.

Still, the U.S. share of IDA-9 will decline to 21.6 percent, compared to a U.S. share of 23.2 percent in IDA-8. Throughout the IDA-9 negotiations, the United States worked to include the following measures to ensure that IDA resources are used in the most effective and efficient manner:

A borrowing country's economic performance, including efforts to alleviate poverty, will receive greater weight as a basis for allocation of resources;

Important new measures to address environmental concerns will be factored into IDA lending;

And efforts will be made to improve IDA and IMF collaboration.

Forty-five to 50 percent of the IDA resources were allocated to sub-Saharan Africa, with the condition that borrowing countries in the region continue to make progress on economic adjustment. This special consideration for sub-Saharan Africa is still in place for allocating IDA-9 resources.

EASTERN EUROPE

In Eastern Europe, developments in East Germany, Czechoslovakia, and Romania have transformed the challenge we faced in Eastern Europe last fall when Poland and Hungary appeared to be well in front of the other countries of this area. The broad-based demands of Central and Eastern Europe pose a challenge for the United States, in particular for our ability to provide financing and economic assistance from our limited resources.

As you know, the Administration is currently discussing with our allies the creation of the European Bank for Reconstruction and Development. Depending on the outcome of these negotiations, the EBRD should offer a vehicle for leveraging U.S. and other resources in a cooperative effort with Europe to address the economic problems associated with Eastern Europe's transition to market-based economies.

If the EBRD is established in accordance with the objectives, it will be the only multilateral development bank with a substantial part of its funding program aimed exclusively at the private sector. In addition, it will focus entirely on Eastern Europe.

The World Bank and IMF will continue to play an active role and deserve our support for their actions in this area.

PRIVATE SECTOR PROMOTION

Mr. Chairman, the recent events in Eastern Europe and elsewhere testify forcefully to the consequences that befall economies lacking a vibrant private sector. This morning I would like to focus on a special aspect of what the MDBs are doing to promote the private sector, the privatization of state-owned enterprises.

Through adjustment lending, the World Bank has assisted in the privatization programs of Congo, Jamaica, Mexico, Morocco, Niger, the Philippines, Togo, and Venezuela. Jamaica and Mexico are notable for having privatized some of the largest enterprises in their economies. In addition, some very large divestitures are now in the process of being privatized in Mexico, including the telephone company, TELMEX, the fourth largest company in Mexico.

Mexico has also announced its intention to privatize Cananea, one of the largest copper mines in the world.

The various departments of IFC provide distinct services to governments and corporations in the privatization process. The recently created Corporate Finance Services Group can manage a privatization from start to finish, from restructuring the company, finding suitable investors, and providing regulatory framework advice, to putting together an underwriting syndicate, or arranging a private sale.

FINANCING THE MDBS

In conclusion, Mr. Chairman, I cannot emphasize too strongly the Administration's commitment and full support for the MDBs. They are of significant and enduring importance to U.S. national interests. Moreover, there is another aspect of the MDBs that is enduring. The burden of financing the operations of these institutions is shared by all member countries.

As I mentioned above, U.S. financial support for the MDBs results in over 21 times that amount of lending as a result of intermediation of private capital markets and the contributions of other donors. Given these benefits, Mr. Chairman, it is essential that we give these institutions our financial support for the United States to continue to play a leadership role.

Thank you.

[The information follows:]

Embargoed Until Delivery
Expected at 10:00 am EST

STATEMENT BY
THE HONORABLE NICHOLAS F. BRADY
SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON FOREIGN OPERATIONS
COMMITTEE ON APPROPRIATIONS
U.S. HOUSE OF REPRESENTATIVES
MARCH 14, 1990

Mr. Chairman and Members of the Committee:

It is a pleasure to meet with you today to discuss the Administration's fiscal year 1991 budget proposals for the Multilateral Development Banks (MDBs) and the International Monetary Fund's Enhanced Structural Adjustment Facility (ESAF), and to review progress in implementing the strengthened debt strategy.

Since my appearance before you last year the world has been transformed. Eastern Europe has undergone changes far beyond what could realistically be expected in so short a timespan. Closer to home, countries in South and Central America are trying to move towards democracy and better economic policies. These events amply demonstrate the soundness of the principles the United States has long advocated: pluralistic, democratic political processes, and a general reliance on the market to allocate resources. But these events -- which certainly mark a "sea change" in global affairs -- do not occasion self congratulation so much as a call for deep reflection as to how to proceed from here.

The changes towards democracy mean that promoting U.S. national interests will rely more on promoting sound economic policies than upon military force. Hence, it is essential that the United States maintain an active leadership role in institutions such as the MDBs, which will have a prominent role in Eastern Europe and Central America.

I know, Mr. Chairman, that you realize fully the United States' long-term self-interest in nurturing these institutions. I want to acknowledge and thank you and members of your Committee for the support you have demonstrated for these institutions. I very much appreciate it. Successful U.S. leadership in these institutions depends on firm backing by the Congress for our international commitments -- commitments made on the basis of extensive Congressional consultation.

For FY 1991, the Administration is requesting $1,736.3 million in budget authority and $6,879.7 million under program limitations for the MDBs. Of this $1,736.3 million, $268.2 million stems from shortfalls from previous requests, and $1,468.1 million is to honor previously agreed payment schedules. It is worth emphasizing that this request -- which seeks funding for on-going programs, a new replenishment of resources for the International Development Association (IDA), and all U.S. MDB funding shortfalls -- has the full backing and support of the President.

For FY 1991 we are also seeking $10.6 million to complete the U.S. contribution to the IMF's Enhanced Structural Adjustment Facility. The specific requests for each MDB "window" and the ESAF are presented in the annex at the end of my testimony.

Mr. Chairman, the United States should make these payments in full, including all arrears -- this year. The MDBs are now lending funds at the rate of about $30 billion annually. U.S. financial support has averaged about $1.4 billion in recent years. That means U.S. dollars are multiplied over 21 times through the intermediation of private capital markets, retained earnings, repayments on earlier loans, and the contributions of other donors. However, U.S. financial support of the MDBs does more than leverage U.S. dollars to promote growth in developing countries and advance U.S. humanitarian concerns -- it leverages U.S. international leadership.

Our ability to exercise international leadership on such issues as developing country debt burdens and protection of the environment has been aided immensely by our standing in the international financial institutions. No doubt, our standing in these institutions is a function of the power of the ideas we put forward, as well as our financial support. But we should not delude ourselves: ideas and financial support must move in tandem to be effective.

Debt Strategy: A Progress Report

Our support for the international financial institutions serves a broad range of U.S. interests. By promoting sustainable growth in developing countries, these institutions help increase effective demand for U.S. exports and reduce the strains on the international financial system. Their programs also foster the development of democratic institutions and promote market-oriented reforms -- making a substantial contribution to democracy and an open world economy. We also rely on the MDBs to protect the delicate global environment that we all share, and to advance U.S. humanitarian interests.

These points make a clear case for our support for the international financial institutions. I want to focus particular attention, however, on the contribution these institutions make through their support of the debt strategy.

A year ago, I testified before this committee on the outlines of a new approach to developing countries' debt problems. This strengthened debt strategy is based on:

- reviving hope in debtor countries and reinvigorating their commitment to economic reform;
- inducing a reduction of commercial bank debt burdens of developing countries as a means of providing financial support for these reform efforts; and
- building confidence in debtor economies and thereby encouraging investment and flight capital repatriation.

To pursue these goals, the international financial community took measures to redirect IMF and World Bank resources to support debt and debt service reduction and to provide continued creditor government support through Paris Club reschedulings and ongoing export finance.

When I presented this framework to you last year, Mr. Chairman, we discussed the potential benefits from this strengthened debt strategy. As I was a year ago, I am confident that our new approach provides a solid basis for progress in addressing debt problems. This year, however, I can cite evidence to confirm that this strategy, through reduced commercial debt burdens and economic reform, can help countries:

- improve their investment climates, bringing capital home and boosting foreign investment;
- revive economic growth; and
- build their potential as active participants in a vibrant world economy.

As you know, Mexico was the first to achieve an agreement with its banks. It is important to note that by the time the agreement was signed on February 4, 1990, 99 percent of the 450 banks with exposure in Mexico chose to participate through one of the three options -- leaving no "free riders" to detract from the package. Built on a strong record of macroeconomic and structural reforms, the agreement produces significant benefits for Mexico.

- Mexico's interest payments to commercial banks will be reduced by one third, or $1.5 billion per year.
- $42 billion of debt payments will be forever removed from the backs of the Mexican people.
- Domestic interest rates have fallen significantly, resulting in savings equivalent to 4-5 percent of GDP.
- Net private capital inflows of $3 billion in 1989 indicate that flight capital is returning home and investor interest is reviving.
- Current projections suggest that, provided reform efforts are sustained, Mexico will achieve growth of 5-6 percent by 1994 and will have reduced its debt service ratios by half.

In short, Mexico has revitalized its economy and looks forward to the future with optimism. In the context of ongoing economic reform efforts, we believe that the Mexican economy will live up to these new expectations.

The agreement between the Philippines and its commercial banks places greater emphasis on new money and direct cash buybacks. The Philippines will experience real benefits as a result, including:

- annual interest savings of $120 million, or 20 percent of scheduled payments on medium-term commercial bank debt; and
- satisfaction of projected financing needs for 1989-90 while achieving a net debt reduction of 10 percent.

Some observers have raised questions about whether this package really offers much in the way of benefits to the Philippines. In fact, it helps demonstrate the flexibility of the strengthened debt strategy and its potential to meet the needs of diverse countries. The Philippines' situation varies significantly from that of Mexico. Its financing needs are much higher relative to its commercial bank debt stock; its commercial bank debt burden is not as heavy. A Mexico-style package would have covered only half of the Philippines' projected financing needs in 1990.

As a result of these circumstances, voluntary new money was featured more prominently in the agreement the Philippines reached with its commercial banks. Debt reduction was pursued through direct cash buybacks because they offer the most effective means of gaining support from banks prepared to exit the Philippines at a steep discount. The Philippines may eventually launch the second phase of efforts to reduce its debt burden, utilizing remaining official enhancements to secure additional debt and debt service reduction.

Costa Rica pursued yet a different course, agreeing in principle with its commercial banks in October, 1989, on a combination of measures including a projected cash buyback at an 80 percent discount and specific measures to address a significant arrears problem. The benefits for Costa Rica are:

- Costa Rica's stock of debt will be reduced by about 60 percent; and
- annual interest rates will be reduced by 60 percent for 20-25 years.

The agreement, once implemented, will leave Costa Rica with a debt service burden which reflects more realistically its ability to pay.

Although these three agreements have received the most attention over the last year, it is important to recognize that this approach to reducing commercial debt burdens can be pursued by any country with medium-term commercial bank debt and a strong commitment to economic reform.

Chile is another country that has made use of the new debt strategy through a limited direct buyback. This step was the latest stage of an ongoing debt reduction program Chile has pursued since 1985 which -- through a combination of debt/equity swap and buyback techniques -- has enabled Chile to retire $7.8 billion in debt, more than half of its pre-1985 medium- and long-term commercial bank debt.

Other countries are moving to seek similar arrangements with their commercial creditors. We understand that Venezuela and its commercial banks are making good progress toward concluding a medium-term financing package involving significant debt and debt service reduction. Morocco has also been discussing a package with its commercial banks. As they adopt strong reform programs with the IMF and World Bank, countries such as Nigeria, Ecuador, and Uruguay will enter talks as well. Following a leadership transition, Brazil may pursue a similar course.

Creditor governments are also making important contributions through the Paris Club -- which is the established forum for rescheduling official bilateral government debt. Creditor governments are now negotiating multi-year rescheduling agreements for debtor countries with medium-term economic reform programs. By rescheduling interest as well as principal on bilateral loans, such Paris Club agreements provide greater immediate cash-flow relief than commercial bank reschedulings or even debt reduction packages. In addition, a number of creditor governments have pledged financial support to enhance specific financing packages.

Some have suggested other approaches to the debt problem which are aimed, in part, to encourge commercial banks to rationalize their developing country portfolios. For example, if debtor countries began building arrears, commercial banks' income would be reduced and the economic value of their portfolios would fall. Outside of short-term cash flows, however, the latter approach would not yield real long-term benefits for debtor countries. Long-term debt burdens would not be eased, market and investor confidence would dissipate, economic reform efforts would likely lag, and prospects for growth would remain dismal. I think we could all agree that such a scenario is not our goal. Rather, we must continue to pursue a strategy which makes commercial bank losses worthwhile by translating them into incentives for reform and improved economic outlooks for debtor countries.

Such an effort under the debt strategy depends fundamentally on the international financial institutions. In addition to continuing their project and policy-based lending over the last year, the IMF and World Bank have begun to provide special support for commercial bank debt and debt service reduction. In support of these packages, these institutions are making available the following funds:

	IMF	IBRD
• Mexico (1989-1991):	$1.7 billion	$2.06 billion
• The Philippines (1990):	$120 million	$ 150 million
• Costa Rica (1990):	$ 54 million	$ 50 million
• Chile (1989):	$ 81 million	

The agreements negotiated between debtor counrtries and their commercial banks could not have taken place without the IMF and World Bank. As advisers and catalysts, these institutions are our fundamental tool for bringing about serious economic reforms, and significant reductions in commercial bank debt burdens.

MDBs and the Environment

Let me turn now, Mr. Chairman, to environmental issues in the Multilateral Development Banks. This is an area in which we have received a substantial mandate from Congress to press for wide-ranging reforms over the past several years. At last count, we had thirty-five separate legislative provisions encouraging us to promote more rapid progress toward one or another environmental objective. The most important of these objectives include environmental impact assessments, promotion of energy efficiency and conservation measures, and greater protection of the natural resource base, particularly tropical moist forests.

Environmental reform has been a key issue in our management of U.S. participation in the MDBs. However, our agenda for environmental reform is based not only on the legislative mandate we have received but also on our perception that environmental considerations must be an increasingly important focal point for all MDB activities.

At last year's Economic Summit meeting in Paris in July, President Bush asked other heads of state and government to join him in encouraging the World Bank and the regional development banks to integrate environmental considerations into all aspects of their activities. At the Annual Meetings of the World Bank and IMF last September, the President encouraged other countries to weigh environmental considerations more heavily in economic decision-making, and said that we need to work more cooperatively together to develop constructive solutions to global warming, including measures to promote energy efficiency and conservation and greater protection of tropical forests.

I have also pursued a broad range of environmental reform issues in numerous international meetings: meetings of the Development Committee of the World Bank and IMF last April and September, the Annual Meetings of the World Bank and IMF last September, and the ministerial meeting of the Organization for Economic Cooperation and Development last May. Other Treasury officials have emphasized the importance of environmental reforms in the annual meetings of the three regional banks. Such reform issues have been an important part of U.S. negotiations to replenish the resources of these institutions, particularly those of the Inter-American Development Bank (IDB) and the International Development Association (IDA). Environmental issues are also being discussed in the negotiations now going forward for establishment of the European Bank for Reconstruction and Development (EBRD).

Clearly our most significant accomplishment over the past year has been inclusion of more stringent environmental provisions in the agreement for replenishment of the International Development Association (IDA) resources. In the IDA-9 report, approved by the Board of Executive Directors of the Bank in January and forwarded to the Governors for their approval, express provisions were made for the following:

- implementation of environmental impact assessment procedures, helping to assure that environmental costs and benefits are weighed carefully early in the project appraisal process;
- increase in public access to environmental information, promoting more participation by local community groups and non-governmental organizations;
- closer collaboration and cooperation with non-governmental organizations in borrowing countries;
- greater emphasis on energy efficiency and conservation including end-use efficiencies, renewable energy technologies and least-cost planning in borrowing countries;
- more support for debt for nature swaps; and
- more rapid progress on environmental action plans.

Other substantial progress has also been made as a result of our leadership. Let me highlight a few of these major accomplishments of the past year. First, in September 1989, the World Bank adopted procedures for assuring that environmental impact assessments are completed for projects that have a significant impact on the environment. This past January, the Inter-American Development Bank established an environmental line unit and assigned fifteen environmental experts to carry out the functions of that unit. It has also sponsored a second meeting of non-government organizations (NGOs) from countries throughout the hemisphere and sought to involve environmental ministries in those countries more actively in preparation of IDB projects. It is now working on environmental impact assessment procedures.

The Asian Development Bank has continued its program for integrating environmental considerations more effectively into the project appraisal process and sought to involve NGOs from developing member countries in the identification and preparation of specific project proposals. The African Development Bank has worked closely with U.S. environmental groups in putting together the first of what it hopes will be a series of conferences with African non-governmental organizations (NGOs) interested in environmental issues.

We are pleased with the progress achieved thus far. At the same time, there is much more to do. In particular, we will have to increase our efforts to assure that the agreements we have reached are implemented effectively. In the World Bank, implementation of environmental impact assessment procedures over the next two years will be a large task. We are consulting with State, AID, EPA, and CEQ about detailing U.S. experts to assist in this process. We are also asking other countries to consider seconding experts for this purpose as well. In the regional development banks, this task will be even more daunting and will almost certainly require additional efforts by us and other developed countries.

In 1988, Treasury encouraged the World Bank to play a more active role in promoting these swaps. One recent encouraging sign has been the Bank's pursuit of a proposal to preserve an important tract of Atlantic Rain Forest in Paraguay. While the deal is not assured, there has been strong support from AID and private conservation groups.

Energy efficiency and conservation measures are another important area in which we will need to do more work. During the past year, Treasury formed an informal working group comprised of experts from AID, Energy, State, EPA and several NGOs to exchange views on how we might encourage greater emphasis on energy efficiency and conservation in the Multilateral Development Banks. Much of the specificity that we were able to achieve in the IDA-9 Agreement grew out of the work of this group. Treasury has also been a member of the Committee on Renewable Energy, Commerce, and Trade, which seeks to encourage greater reliance on renewable energy technologies in developing countries. We are currently monitoring a program funded by the World Bank in collaboration with this committee to promote greater efficiencies in household uses of energy in several countries in the Far East.

In spite of our efforts and the real progress that has been achieved within all of the banks, environmentally problematic projects continue to come forward for board consideration. Last year, in cooperation with other countries, we stopped a major power loan that would have had far-reaching negative effects on tropical forests in Latin America. Now we are increasingly concerned about forestry projects in other regions, including those that are part of the Tropical

Forestry Action Plan, seeking to have greater emphasis placed on protection and preservation measures. We have encouraged the World Bank to adopt standards for evaluating projects that may adversely affect tropical forests, and are hopeful that it will do so later this year.

International Development Association (IDA)

Mr. Chairman, in addition to the finance provided through the MDB capital loan "windows," it is critical to provide special support for the low-income developing countries. The principal vehicle for this is the International Development Association. In December 1989, negotiations were completed for the ninth replenishment of IDA resources (IDA-9). IDA, an affiliate of the World Bank, is the world's single largest source of MDB lending on concessional terms. IDA plays a pivotal role in alleviating poverty and enhancing development in the poorest nations. Only countries with per capita incomes of $580 (in 1987 dollars) or less are offered IDA credits. However, the majority of IDA lending goes to countries with per capita incomes of less than $400. The ninth replenishment -- intended to fund credits to be committed during the three year period July 1, 1990 to June 30, 1993 -- will total approximately $15 billion.

An important goal of the replenishment is to maintain the size of IDA in real terms. This goal will be achieved with the assistance of the United States, which agreed to maintain the amount of its IDA-8 contribution in real terms for IDA-9. The U.S. contribution to IDA-8 was $2,875 million, $958 million annually. We are requesting authorization for a U.S. contribution to IDA-9 of $3,180 million, or $1,060 million annually for three years. Thus, the U.S. contribution would increase by $102 million a year. Still the U.S. share of IDA-9 will decline to 21.6 percent compared to a U.S. share of 23.2 percent of IDA-8.

Donor contributions combined with advance commitments from reflows will support an annual lending program of about $5.5 billion.

Throughout the IDA-9 negotiations which began in early 1989, the United States worked for measures to ensure that IDA's resources are used in the most effective and efficient manner. In this regard, the United States achieved its three major policy objectives:

- a borrowing country's economic performance, including efforts to alleviate poverty, will receive greater weight as a basis for allocation of resources;

- important new measures to address environmental concerns will be factored into IDA lending, as was mentioned above in the discussion of the environment; and

- efforts will be made to improve IDA and IMF collaboration.

Poverty reduction remains central to IDA's mandate and will play a major role in the policy dialogue with recipient countries. During IDA-9, increased weight will be placed on poverty alleviation in the allocation of IDA resources. In addition, greater effort will be made to protect the poor during the adjustment process and to involve the poor in an equitable development process. Finally, it is hoped that IDA will assist recipient countries to assure that their national plans and strategies encompass measures to eliminate the causes of and alleviate poverty.

Forty-five to fifty percent of the IDA-8 resources was allocated to Sub-Saharan Africa, with the condition that borrowing countries in the region continued to make progress on economic adjustment. This special consideration for Sub-Saharan Africa is still in place for allocating IDA-9 resources.

Although extended on concessional terms, the standards for IDA credits are the same as those for IBRD loans -- technically, economically, financially, and environmentally sound, compatible with a sound development plan, and of high priority for the economic development of the country. Japan, Germany, France, the United Kingdom, Italy, and Canada have agreed to provide about 57 percent of IDA-9 resources. Since other countries share the costs of providing IDA credits, IDA is an extremely cost-efficient way for the United States to express its humanitarian concern for the poorest of the world.

IDA has also undertaken an initiative to help ease the burden of commercial bank debt on the poorest countries. As a result, $100 million of IBRD net income from FY 1989 was targeted last fall to finance commercial bank debt reduction in IDA-only countries. Eligibility for these resources is conditioned on strong economic reform programs and sound debt management strategies.

Finally, Mr. Chairman, in the context aiding the poorest of the world, I want to note that the United States and other official creditors are taking measures to assist the least developed countries that pursue sound economic reform programs. These measures include both special treatment ("Toronto terms") for the poorest countries in Paris Club reschedulings and bilateral actions to convert old development assistance loans into grants. We are moving ahead with a $850 million program to forgive economic assistance loans to Sub-Saharan African countries pursuing economic reform. So far this program has been made available to 14 countries.

Eastern Europe

Developments in East Germany, Czechoslovakia, and Romania have transformed the challenge we faced in Eastern Europe last fall when Poland and Hungary appeared to be well in front of the other countries of the area. The broad-based demands of Central and Eastern Europe pose a challenge for the United States, in particular, for our ability to provide financing and economic assistance from our limited resources.

As you know, the Administration is currently discussing with our allies the creation of a European Bank for Reconstruction and Development (EBRD). Depending on the outcome of the negotiations, the EBRD should offer a vehicle for leveraging U.S. and other resources in a cooperative effort with Europe to address the economic problems associated with Eastern Europe's transition to market-based economies. As a multilateral bank with paid-in and callable capital, the EBRD would receive funding from its membership and have the backing of members to borrow from their capital markets. Members' contributions could therefore be leveraged through this type of facility just as they are through the World Bank.

It is important to point out that the United States can demonstrate considerable support for Eastern Europe by supporting the World Bank. The World Bank has initiated a program to lend $5 billion dollars to Eastern Europe over the next three years, including $2.5 billion to Poland. In fact, $1,127 million in loans is now pending for Poland, $586 million is pending for Hungary, and $1,370 million for Yugoslavia. Despite the strongly held political rationale in Europe for forming the EBRD, we should not forget that the World Bank is an established, fully functioning institution now -- not a year or two down the road. On the other hand, if the EBRD is established in accordance with our objectives it will be the only MDB with a substantial part of its lending program aimed exclusively at the private sector. In addition, it will focus entirely on Eastern Europe.

Promoting the Private Sector

Mr. Chairman, the recent events in Eastern Europe and elsewhere testify forcefully to the consequences that befall economies lacking a vibrant private sector. This morning, I would like to focus on a special aspect of what the MDBs are doing to promote the private sector -- the privatization of state-owned enterprises (SOEs).

Privatization is a global economic movement which the MDBs are encouraging. Privatization of SOEs is a critical instrument in the international debt strategy. It has the dual benefits of reducing government financial obligations and allowing companies to act on market incentives. The MDBs are well-situated to assist governments in the difficult and complicated process of planning and implementing a privatization program.

For example, the World Bank encourages government efforts to privatize SOEs through loans which provide for divestiture and other methods of privatization, as well as liquidation of insolvent SOEs. At the recommendation of the Private Sector Development Review Group, the Bank is expanding its support for privatization of SOEs through:

- research on the institutional and incentive framework;
- legal analysis of privatization;
- increased privatization components of adjustment loans and country economic sector work;
- consideration of ways to increase the role of the private sector in the provision of infrastructure and social services;
- expansion of adjustment lending for financial sector reform; and
- promotion of direct foreign investment.

Through adjustment lending, the World Bank has assisted in the privatization programs of the Congo, Jamaica, Mexico, Morocco, Niger, the Philippines, Togo, and Venezuela. The number and economic significance of the SOEs privatized vary widely from country to country. However, Jamaica and Mexico are notable for having privatized some of the largest enterprises in their economies. The Jamaican Government has divested itself of Caribbean Cement, the National Commercial Bank, and Telecommunications of Jamaica. Mexico divested enterprises such as Mexicana De Aviacion, Aeromexico, and several important railroad companies. Some very large divestitures are now in the process of being privatized, including the telephone company TELMEX, the fourth largest company in Mexico (the oil company PEMEX is the largest). Mexico has also announced its intention to privatize Cananea, one of the largest copper mines in the world.

The various departments of IFC provide distinct services to governments and corporations in the privatization process. The recently created Corporate Finance Services group can manage a privatization from start to finish -- from restructuring the company, finding suitable investors, and providing regulatory framework advice, to putting together an underwriting syndicate or arranging a private sale.

Through Advisory Services, the IFC provides feasibility studies to governments planning to embark on a privatization program. IFC's Capital Markets Department arranges for portfolio investment in privatized SOEs and can underwrite their corporate equity offerings. Finally, IFC's Regional Investment Departments contribute to privatization through their experience in the appraisal and financing of projects in various industries. Project investments may lead to privatization as the government sells its shares in an enterprise to private investors.

The IFC is well-positioned to be an "honest broker" in privatization transactions, reconciling the differences that arise between the various interest groups in implementation. The IFC assisted in privatization projects covering a broad cross-section of economic sectors in Argentina, Indonesia, Jamaica, Liberia, Malaysia, Mozambique, Nepal, Nigeria, Pakistan, Philippines, Rwanda, Swaziland, Togo, Trinidad and Tobago, Tunisia, and Venezuela.

The Multilateral Investment Guarantee Agency (MIGA) provides policy advice regarding foreign investor participation in privatization through the Foreign Investment Advisory Service. MIGA will also make guarantees available for investments in privatization of an existing SOE.

The privatization efforts underway with World Bank Group assistance are numerous and varied. The success of programs underway in Jamaica, Mexico and the Philippines will encourage the privatization process in other developing countries. However, privatization should not be a goal in and of itself. An economic environment conducive to growth and efficiency is necessary for private firms to be more productive than SOEs. A financial sector that efficiently mobilizes resources and allocates credit is critical to a strong private sector.

Conclusion

Mr. Chairman, I cannot emphasize too strongly the Administration's commitment and full support for the MDBs. As you know full well, they are important instruments in the conduct of U.S. foreign and international economic policy. In concluding my remarks today on the MDBs I want to mention briefly -- to remind ourselves -- of their invaluable attributes. The MDBs:

- complement U.S. financial support to countries strategically important to the United States which receive U.S. bilateral economic assistance, such as Pakistan, the Philippines, and to countries like Mexico which receive no U.S. economic assistance;

- greatly enhance U.S. ability to react positively to changes in the political landscape such as the events in Eastern Europe and Central America, and to changes in the economic landscape like Third World Debt problems and awakened environmental concerns;

- advance the broad U.S. economic objective of promoting the growth of a free, open, and stable economic and financial system by encouraging and supporting developing country movement toward more open trade and capital flows, including greater reliance on the private sector and free market pricing;

- support the U.S. objective of improving the quality of life for impoverished people in developing countries, particularly through soft loan windows, and special funding for social programs;

- contribute to expanding employment in the United States by increasing exports both directly from procurement stemming from finance provided by the MDBs, and indirectly through other procurement possibilities generated by the non-MDB finance associated with MDB projects. (U.S. business has received $15.2 billion cumulatively from the World Bank, which is 9 times U.S. paid-in capital. There are also tertiary benefits from business generated through contacts established in bidding on MDB projects.)

Mr. Chairman, the vital role of the MDBs is of signal and enduring importance to U.S. national interests. The important attributes the MDBs exhibited during the cold war remain essential qualities as the cold war abates.

Moreover, there is another aspect to the MDBs that is enduring: the burden of financing the operations of these institutions is shared by all member countries. As I mentioned above, U.S. financial support for the MDBs results in over 21 times that amount of lending as a result of intermediation of private capital markets and the contributions of other donors. The cost to the United States of trying to duplicate bilaterally what is achieved through the MDBs would be prohibitively expensive.

Given these benefits, Mr. Chairman, it is essential that we give these institutions our financial support for the United States to continue to play a leadership role.

ANNEX

Fiscal Year 1991 Budget Request

We are requesting $1,736.3 million for the MDBs and $10.6 million for the IMF's Enhanced Structural Adjustment Facility (ESAF) in FY 1991. These funding requests reflect both the need for budgetary restraint and the financial requirements for effective development programs. Our MDB request is comprised of MDB funding requirements currently due for payment, $1,468.1 million, and $268.2 million in U.S. funding shortfalls to the MDBs. These requests are composed exclusively of funding requirements negotiated by the Administration in close consultation with this Committee.

International Bank for Reconstruction and Development (IBRD)

For the IBRD (also known as the World Bank) in fiscal year 1991, the Administration is requesting: 1) $40.5 million in budget authority and $2,241.9 million under program limitations to complete the first and second installments to the 1988 General Capital Increase (GCI); and 2) $70.1 million in budget authority and $2,267.4 million under program limitations for subscription to the third installment.

The Bank's principal role today is making long-term credit available for productive projects, which will lead to economic and social development in its less developed members. These loans carry market interest rates. In addition to project finance, the IBRD provides policy advice and technical assistance and financing in support of structural reform, and serves as a financial catalyst and institution builder.

International Development Association (IDA)

For fiscal year 1991, the Administration is requesting: 1) $4.1 million to complete the third and final installment to IDA-8, and 2) $1,060 million for the first of three installments for the $3,180 million U.S. share of the ninth replenishment of IDA resources. IDA, an affiliate of the World Bank, is the single largest source of development assistance for lending on concessional repayment terms to the world's poorest countries. Over 96 percent of IDA lending goes to countries with an annual per capita income of $400 or less.

International Finance Corporation (IFC)

For fiscal year 1991, the Administration is requesting: $40.3 million in U.S. funding shortfalls to complete the U.S. subscription to the $650 million IFC capital increase. The IFC provides risk capital as well as long-term loans; plays an important role as a catalyst in attracting private capital; and provides technical assistance to developing countries that want to encourage domestic and foreign private investment.

Inter-American Development Bank (IDB)

For fiscal year 1991, the Administration is requesting (1) $0.136 million in budget authority to complete the U.S. commitment to the sixth IDB capital increase; and (2) $57.3 million in budget authority and $2,235.1 million under program limitations for subscriptions to the the first of four installments to the seventh capital increase of IDB resources (IDB-7). The Bank makes loans at market related rates. The lending program is designed to help the long-term development of the countries in Latin America and the Caribbean.

Fund for Special Operations (FSO)

For fiscal year 1991, the Administration is requesting (1) $0.274 million in budget authority to complete the U.S. commitment to the sixth increase in FSO resources; and (2) $20.6 million in budget authority for the first of four installments for the $82.3 million U.S. share in the FSO component of the seventh increase of IDB resources (IDB-7). The FSO lends on concessional terms and addresses the long-term development needs of the poorest countries, primarily in Central America and the Caribbean.

Inter-American Investment Corporation (IIC)

For fiscal year 1991, the Administration is requesting $25.5 million in U.S. funding shortfalls to the IIC. These funds, for the third and fourth of four installments to the IIC, would complete the U.S. commitment to this institution. The IIC is linked to the IDB, and is designed to support private sector activities in Latin America through equity and loan investments that focus primarily on small- and medium-scale enterprises.

Asian Development Bank (ADB)

The ADB is currently making lending commitments on the basis of capital stock that is fully subscribed by Bank member countries, including the United States. Hence, there is no need to request funding for the ADB in fiscal year 1991. The Bank makes loans at market rates to developing member countries in a region of world of key importance to U.S. strategic and economic interests.

Asian Development Fund (ADF)

For fiscal year 1991, the Administration is requesting: 1) $155.7 million in U.S. funding shortfalls to the second and third installments to the fourth replenishment of ADF resources; and 2) $146.1 million for the fourth and final regularly scheduled installment. The ADF is a source of concessional finance to the poorest member countries of the ADB. Pakistan, Bangladesh, Sri Lanka, and Nepal are the major borrowers from the Fund.

African Development Bank (AFDB)

For fiscal year 1991, the Administration is requesting: 1) $1.1 million in budget authority to subscribe to paid-in capital and $0.580 million in program limitations to complete the third of five installments to increase the Bank's capital base; and 2) $9.0 million in budget authority and $134.8 million under program limitations for the fourth U.S. installment. The Bank makes loans on market-related terms for the economic and social development of fifty African member countries, individually and through regional cooperation. The AFDB is an important part of the U.S. commitment to work with the countries of Africa for the achievement of their long-term development objectives.

African Development Fund (AFDF)

For fiscal year 1991, the Administration is seeking $.452 million in budget authority to complete the second of three installments for the U.S. contribution to the fifth replenishment of AFDF resources; and (2) $105 million for the third and final installment. The Fund complements AFDB operations by providing concessional financing for high priority development projects in the poorest African countries. The United States has a strong humanitarian interest in aiding the poorest countries of the world's least developed continent through its support for the AFDF.

IMF Enhanced Structural Adjustment Facility (ESAF)

For fiscal year 1991, the Administration is requesting $10.6 million in budget authority to complete a one-time U.S. contribution of $150 million to the Interest Subsidy Account of the ESAF. The ESAF provides financial assistance on concessional terms to the poorest countries experiencing protracted balance of payments problems.

Mr. OBEY. Thank you, Mr. Secretary.

ROSTENKOWSKI BUDGET PROPOSAL

Mr. Secretary, I do not want anyone to misinterpret my original comments expressing my concern about the delayed Treasury reports. I want to make it quite clear that we appreciate the relationship we have with you. I think you are very open, very accessible, and without much guile, which I very much appreciate. I am glad there are still some people in this town who tell you where they are coming from, even if you do not necessarily agree with where they are coming from.

Let me ask you a question that I think we can dispose of quickly. As you know, this town has heard much talk about the Rostenkowski plan, which surfaced yesterday. The overall budget situation determines how much flexibility all the committees, including this one, have to respond to Administration and other requests.

I assumed from the moment I heard the Rostenkowski proposal on the budget that it was probably DOA. I ought to ask you, as one of the key Administration players on any decisions with respect to the budget, how we are to interpret the President's comments reported in the paper this morning. He said that, "We are prepared to negotiate, but there is a lot that I am not for in his proposal, including the taxes." Mr. Darman indicated that, "The reality is that they are not going to raise taxes without the Administration." Then he goes on to say, "You cannot go into negotiations and say that absolutely, completely it is inconceivable that you would consider anything."

We have already spent a great deal of time on the Moynihan diversion this year. Should we be spending more time thinking about this, worrying about this? Or should we assume this is just another shot in the dark which is not likely to go anywhere? Is there really any inclination on the part of the Administration to accept and expand upon the rough outline of the Rostenkowski proposal? Or is that something we should assume has already bitten the dust?

Secretary BRADY. Well, I do not think we should assume it has bitten the dust. What the President said a number of times in his press conference yesterday, and what I think is the main point that we should get out of those comments, is that this is a comprehensive approach on behalf of a chairman who has inside his Committee an enormous amount of the parts of what would ultimately be necessary in a budget resolution. I think he says some 75 percent.

It is the comprehensive nature of his approach that appeals to the President. At the same time, there are parts of it, which do not need repetition, that in the President's view are unacceptable.

But I think it indicates a feeling on his part—to some degree built on the fact that we are facing new challenges, a great many of which are being discussed this morning—that we have to have a solution to these problems. To have somebody stand up and say, here is a solution, the President's feeling was maybe we should sit down and start talking about the details of this program.

Since the President's budget was put forward—a lot of the elements of which I know you and others do not agree with—we have not had much conversation. So I think it was a relief that there was at least a plan put forward that we could operate on.

Parts of the plan do not suit the President. On the other hand, it is comprehensive.

Mr. OBEY. Are there any pieces of the Rostenkowski plan which are off the table for consideration as far as the Administration is concerned?

Secretary BRADY. Well, I think the President has said that he is not going to put anything off the table. He has put his own plan forward. Here is a plan coming out of the chairman of the Ways and Means Committee. There are Budget Committees that obviously—you know better than I—have to be comprehensive in their approach.

Until we see what those plans are, nothing is off the table and never was. Our suggestions as to how to provide the revenues are spelled out in the President's budget.

Mr. OBEY. Are you saying you are not, at this point, totally closed to the Rostenkowski revenue proposals?

Secretary BRADY. No, I did not say that, because the President spoke out quite clearly yesterday on the matter of taxes. He also indicated, or if he did not Director Darman did, that providing revenues is better done through the approach in the Administration's budget.

But I think we ought to make sure we have a distinction clear, which is that nothing is off the table in the negotiation. We are not going to walk out of any rooms. Neither would we expect Congress to walk out of any rooms when we come forward with proposals.

But while nothing is off the table, that does not mean the detailed elements of Rostenkowski's plan are acceptable. I know those are things that sound like saying one thing and doing another, but here is a comprehensive approach to the budget put forward by a very important chairman, and we think that that is progress.

PHILIPPINES' DEBT SITUATION

Mr. OBEY. Okay. Now let me turn to the debt situation——

[Disturbance in the back of the room.]

Secretary BRADY. I will be quiet, Mr. Chairman.

Mr. OBEY. The baseball strike must be over. [Laughter.]

Let me ask you about the debt situation because, as you know, we have had a significant degree of difference with the Administration. The Treasury cites Costa Rica, Philippines, and Mexico as successes of the Brady Plan.

Let me be the first to stipulate that I think the Costa Rican deal is a good agreement. I think everybody assumes that is the case. You had a cash buyback of sixty percent of the commercial bank debt, as I understand it, at less than 20 cents on the dollar. That was real debt reduction.

However, as I look at the case of the Philippines, which the Treasury cites as a success story, that deal provided a buyback of about $1.2 billion of commercial bank debt at a fifty percent discount. I do not want to debate whether it was a good or bad deal. I simply want to see whether you disagree with any of these numbers. Is it true that the net effect of the deal, including a new IMF lending of $1.17 billion, together with new World Bank lending, new Japanese, and new commercial bank lending of about $700 million will increase, not decrease, total Philippine debt stock?

Is that not in fact correct?

Secretary **Brady**. Let me just ask Charles Dallara, who is Assistant Secretary, if that is correct?

Mr. **Dallara**. Mr. Chairman, the IMF and World Bank lending you indicated is over a two or three year period, I believe. The Philippines have indicated they intend to return to the market for further debt reduction or debt service reduction.

Mr. **Obey**. I understand, but I just want an answer to my question. Is it not true at this stage in the process that you have a net increase in Philippine debt stock?

Mr. **Dallara**. I believe that is correct, Mr. Chairman, but only over the full three-year period.

Mr. **Obey**. I understand, I understand.

Secretary **Brady**. Mr. Chairman, could I? Are you going to discuss the Philippines?

Mr. **Obey**. Yes.

Secretary **Brady**. Okay. I would like to comment at the end.

Mr. **Obey**. Sure.

Is it not true also that the agreement shifts a proportion of the debt stock, and thereby the potential liability for the Philippine debt burden, even further to the international financial institutions?

Secretary **Brady**. I would say that is correct.

Mr. **Obey**. Okay. Now, did you want to add any point on the Philippines before I move to Mexico?

Secretary **Brady**. Yes, I would. I think it is important to recognize, since we see each of these deals as different, that we have two goals in mind. One goal is debt and debt service reduction, so a smaller amount of the debtor country's GNP is dedicated to paying back banks. This enables the debtor to buy imports and a lot of other things that are important. That is one goal.

The second goal is you have to have enough money to support the country's economic program. And when we do the actual mechanical calculations with regard to a debt transaction, it has two sides to it. One is the debt reduction and trying to bring the total debt down. Which in this instance in the short run in the Philippines, this is not the case. And, there is less debt reduction in comparison to the other packages.

The other goal is enough money on an annual basis to make sure that the country can continue to grow and do the things it has to do. That will vary from country to country.

Mr. **Obey**. All right, I understand that is the Administration's view. We could all debate whether these issues or these deals are effective or not. I am simply trying to tie down the numbers to illustrate a point. So far, while we disagree on the interpretation, you have not disagreed with my numbers with respect to the Philippines. That is correct, is it not?

Secretary **Brady**. It is not even a disagreement with the interpretation. It is an additional factor.

Mr. **Obey**. Okay.

Secretary **Brady**. I would say you have to have both.

Mr. **Obey**. My numbers are correct right? That is what I am trying to lead up to.

Secretary **Brady**. Can I also just say one thing with regard to the Philippines? It is a strange fact that the greater the commercial debt a country has, the more debt reduction contributes to the country's ability to meet its annual financing needs.

So in the case of the Philippines, where you had a low amount of commercial debt, you cannot get all of the juice you need out of that.

Mr. **Obey**. I understand. Let me explain why I am asking these questions. I do not agree with Mr. Edwards' assertion that providing direct bilateral aid rather than multilateral aid is a better deal for us. I think that if the banks are used the way they are supposed to be used, all other things being equal, we get a much better, bigger bang out of the IFI's than we get out of bilateral funding.

If that is going to be the case, we have to be sure we are not at the same time building a very dangerous house of cards in which recipient countries eventually collapse with respect to their ability or willingness to repay debt. If we do that we will then be engaged in a sort of shell game, which may work for a while, but will eventually snap back at us.

If we run into a significant world recession for instance, we will have some nasty surprises facing the international monetary system, not to mention American taxpayers. That is the point or context in which I am asking these questions.

MEXICO DEBT SITUATION

Now let me get to Mexico. In Mexico, before the Mexican deal, secondary debt was going for approximately 39 cents on the dollar, was it not? Is that not roughly what was happening in Mexico?

Secretary **Brady**. Last July the debt was trading at 45 cents on the dollar.

Mr. **Obey**. Okay. After the deal, the banks effectively wrote down about thirty-five percent of that. They have retained an ability under the deal to be repaid approximately 65 cents out of every dollar, right?

The banks have gotten a substantial benefit out of the Mexican deal, right?

Secretary **Brady**. Do you want me to comment as you go through these points or wait until the end?

Mr. **Obey**. Yes.

Secretary **Brady**. Well, let me back up one, then. On the suggestion that this could be called a shell game, I think what we have here is a way station on the way to, ultimately, getting this job done——

Mr. **Obey**. I want it to be a way station, but I am afraid it will turn into a shell game if the economy collapses. As the guy who has to carry a larger burden in the Congress for funding international financial institutions than any other person, I have got to be convinced that what we are doing does not just make short-term sense, but it is sound in the long term.

My honest conviction, at this point, is that it is not sound. I philosophically agree with Mr. McHugh, but for very different reasons, about the desirability of our funding the banks under these conditions.

Secretary **Brady**. Well, I understand the chairman's concern. I think we make incremental progress on this problem, and I think this last year's activities represent that.

Now, with regard to Mexico may I just comment that the difference between 45 cents that was stipulated as the market for Mexican debt and the 65 cents on the dollar that the banks finally received—that was a thin market. You could not have sold all of Mexico's debt at the price of 65 cents.

And I do not believe that if you made a bid to a bank today to buy Mexican debt from them at 50 cents on the dollar you would get many banks who would do it.

So it is not just a question of the discount. It is also the question of the probability of prompt payment, and risk the banks are still assuming.

Mr. **Obey**. I understand. At this point the deal offers the chance to these banks to get essentially 65 cents on the dollar, as opposed to 39 cents on the dollar before the deal.

Secretary **Brady**. It does offer that chance, but I think when comparing a market price to that discount you really ought to take into account the residual risk on the bonds. I do not know what that debt is selling for in the market today. I would doubt that it is 65. I think it is probably a lot lower than that.

Mr. **Obey**. Okay. Well, if that is true it suggests to me that the banks should have been willing to take a deeper hit. But nonetheless, here is my point. You had a $100 billion debt stock. This deal covers about half of that, right? The banks' debt reduction amounted to $6.6 billion roughly, right?

Mr. **Dallara**. The amount of debt reduction from the exchange of bank debt is $7 billion, Mr. Chairman.

Mr. **Obey**. Okay.

Mr. **Dallara**. But that does not include the debt equity reduction of $3.5 billion.

Mr. **Obey**. I understand.

Mr. **Dallara**. The total debt reduction is——

Mr. **Obey**. The offset that you had through increases in public guarantee of debt, that includes $7 billion in IMF, World Bank, and Japanese participation; $1.2 billion of commercial banks' new lending; and the World Bank continuing its regular lending program, as I understand it. So is it not true that the external debt in 1992 would in fact be higher than it is now for Mexico?

Secretary **Brady**. Well, do you want to give the particular answer?

Mr. **Dallara**. Well, just to say that is not our calculation, Mr. Chairman.

Mr. **Obey**. How does your calculation differ?

Mr. **Dallara**. Well, mine includes, for example, $3.5 billion in debt-equity swaps, which will reduce the debt, that I do not think were captured in yours.

Mr. **Obey**. That switches the international debt for domestic debt, right?

Mr. **Dallara**. What we are talking about here is their level of external debt, Mr. Chairman, not the level of domestic debt.

Mr. OBEY. Well, all right. I know where we disagree.

Let me simply say that when Mr. Colby, the former Director of the CIA was here, he said, "The Brady Plan in ten or twelve months of negotiation has produced one agreement in Mexico, which will save the Mexican government about a billion dollars out of the $9 billion that it pays every year. That is a tiny impact on an enormous problem. It is like sending a squad to fight a division. You are not going to get very far with that."

Do you disagree with his number? Frankly, we have had trouble getting out of the Treasury a specific estimate of what the annual debt service reduction will be. Do you disagree?

Secretary BRADY. Mr. Chairman, if I can just for a minute talk about the Mexican transaction. With respect to Mr. Colby, I think he ought to read the whole document before he comments on the Mexican transaction.

One fact that I cannot understand is how somebody like Mr. Colby continues to ignore the fact that somewhere between $35 and $40 billion of debt are taken off the backs, the shoulders, of the Mexican people.

Mr. OBEY. No, no. With all due respect, Mr. Secretary, that is a different question. You are talking about total debt reduction and that is not my question. I am asking what the annual difference is in debt payments which they pay, because that is what determines ability to pay in any one year.

Secretary BRADY. I thought you were talking about Mr. Colby, who I think you quoted as saying not much was done. And I was just arguing that——

Mr. OBEY. Mr. Colby used the figure of one billion dollars. I am not asking you to agree with his case. I am again citing his numbers. He said:, "This will save the Mexican government about one billion dollars out of the $9 billion that it pays every year." Are those numbers right or wrong?

Secretary BRADY. I think that—well, it may be right in some limited sense. But what I think he ignores completely is the fact that the construction of the Mexican financing is such that at the final payment date for the $40 billion of bonds that are outstanding, that those bonds will be paid for——

Mr. OBEY. We understand that.

Secretary BRADY. Well, but that is significant in my opinion.

Mr. OBEY. I am not suggesting it is not. I am simply trying to get the right numbers, because we have not had much success in getting them. It is true, with respect to annual debt repayment. Mr. Colby's numbers are correct—that out of an annual $9 billion repayment schedule, this deal takes about a billion dollars off that annually?

Mr. DALLARA. The $9 billion figure is probably correct if you include short-term, the interest payments on short-term trade credits and other things.

Mr. OBEY. All right. That is all that I am trying to get at, because I am trying to quantify. I am trying to cut through your rhetoric and my rhetoric and simply quantify what it means bottom line, annually, in terms of reduced need to pay out funds externally. That is all I am trying to do.

Mr. **Dallara**. Could I make one quantification point, Mr. Chairman?

Mr. **Obey**. Sure.

Mr. **Dallara**. The focus which you have stressed and which we have stressed has been the medium-term debt, and I do think it is potentially misleading to include in these calculations the interest payments on very short-term trade credits, which I do not think any of us have ever suggested should be subject to rescheduling, because that would probably disrupt the trade credit line.

If you focus on medium-term debt——

Mr. **Obey**. I am not suggesting that we should. I am suggesting we quantify the actual difference.

Mr. **Dallara**. I believe Mr. Colby's figures probably do, and the figure of $1.5 billion stands up, I think, very well against the total annual interest payments to banks on the medium-term debt of roughly $4.5 billion.

Mr. **Obey**. Okay. My time has expired. I will get back to the point.

BRADY PLAN IMPACT

Let me simply say, what I have just walked through the three cases the Administration has cited as success models for the Brady Plan. I have granted that the Costa Rica model most certainly is a success. The Philippines, I suggest, is an example of exactly what we do not want. That is to wind up dumping a large amount of debt on a country and in the process increase the risk to the taxpayers.

With respect to Mexico, I would say it is an achievement. I would not describe it as being the giant leap which some have. We can have an honest disagreement about that. It is an achievement and I give you credit for as much as you were able to get.

I think the banks should have been willing to take a deeper hit. Until it is extended beyond Mexico, we still have no demonstrable proof the Brady Plan is in fact going to mean anything even if we grant what the Administration says about the Mexican deal. This still brings into question how much real action we are going to get on the debt front with respect to the rest of this hemisphere.

I have exceeded my time.

Secretary **Brady**. Mr. Chairman, may I just say that I think there soon will be other transactions similar to Mexico, and that that to me indicates that we are making progress.

With regard to Mexico, the first deal where banks are willing to take a loss, is always the hardest. We established a principle which was followed on in Costa Rica and I expect will be followed on with other Latin American countries.

Mr. **Obey**. Well, as I have indicated, my willingness to personally support funding the banks is really going to be determined by the success that you have in moving on beyond the Mexican plan. When that occurs, I will be happy to provide funding.

I have a commitment to you that I will put the money in the supplemental because of the agreement we reached in conference last year. I have an agreement with you that I will put that money in my mark when I recommend the supplemental to the committee. Whether or not I will personally support keeping it in through the process will be determined by what kind of success we will see down the line. So far, I have to say I still do not think we have seen sufficient success to justify putting it in. Although I will ministerially keep my commitment to the Administration in that respect, I am still going to argue that it ought to come out again unless something happens before the markup to demonstrate that you are in fact moving along.

I am sorry, Mickey. Go ahead. I have far exceeded my time.

FUNDING OF MULTILATERAL DEVELOPMENT BANKS

Mr. **Edwards**. Actually, Dave, time limits and chairmanships are inconsistent principles. [Laughter.]

I ought to say to you, I do not think you and I are that far apart in our reaction to the multilaterals. My opposition to the funding of the multilaterals is based on the fact that I do not see that they are working correctly. That is in a couple of areas.

One of them which you have made is the way that they have caused debt to accumulate on nations which are really unable to bear those debts. And of course I also have a concern about the fact that we do not seem to have the control over the multilaterals that we always assert that we have.

We are not really players, in the sense that the banks do continue to provide funds to nations which are doing things fundamentally inconsistent with our national interest. It is hard to justify doing that merely because every dollar of ours is made six dollars when you put it in a multilateral bank if it is going for something that is not in our interest.

But having said that—and you know that; I have been saying that for a long time—let me ask you about two areas, one about Europe and one about China.

NEGOTIATIONS ON THE EUROPEAN BANK

First, in terms of the European Bank, could you tell us the status of the negotiations in regard to the bank. Since it looks like we are going to be playing a sufficient role in it, where do the negotiations stand in discussing the eligibility of nations, the level of democratization which would have to be achieved before a nation would be qualified to receive loans, what role the Soviet Union would play in the bank, either directly or indirectly?

How does the putting together of that bank shape up at this point?

Secretary **Brady**. Congressman, first of all I think we should realize that the initiative for the EBRD was one which was put forward in December of this year by French President Mitterand. He brought it to our attention in the first instance by a meeting with President Bush.

And it is quite clear that this bank will go forward whether the United States is part of it, or not part of it. I want to just emphasize that point because many of the prescriptions as to how the bank would operate were put forward by the French, who initially suggested that the bank would be something that the European Community would sponsor and go forward with on its own.

With regard to the type of borrowers, it is our understanding based on the present condition of negotiations that these loans would only be available for pluralistic, democratic societies. Having said that, the problem becomes how do you define that, and we are in the process of trying to get those definitions clear enough so that our understanding of a pluralistic, democratic society is one that we all can agree to.

With regard to Soviet lending, this is one of the real sticking points. Our position is that the United States does not want to be part of the bank if in fact a major part of the funds are diverted to Soviet lending. We said we completely understand the Soviet Union's point of view that they also have requirements, but we have said to them that any requirements of theirs reduce the money available for the Eastern Bloc, those countries that have made the change and that look like they are further on the way to what we understand are open, democratic societies.

Our position is that we would not be willing to join the bank if the Soviet Union had borrowing powers greater than their own paid-in capital. It seems to us that if they borrowed back what they put in, then that is a net zero. But we are unwilling to go further than that at this particular time, period.

WORLD BANK LOANS TO CHINA

Mr. Edwards. Let me also ask about China. I have been concerned, as have a number of other members in Congress, about what happened in China and about whether or not the reaction of the Administration was sufficient in regard to Tiananmen Square.

I understand that the World Bank has approved a very sizable loan to China—I think it was $800 million—with the approval of the United States. So, the result of all of our reaction against what happened in China is that there will be some reduction in the funding that China gets and some delay, but no fundamental serious damage to China as a result of what was done by its leaders.

Are you satisfied with what our policy is at this moment toward China? Are you satisfied with the loans that are going forward to China? What changes do you think ought to be made to better reflect the concerns that we have?

And I say that not just trying to go back to the Tiananmen Square issue but the President when he justified his reaction, which was restrained at least, toward what happened in China, indicated that it was necessary to do certain things to help Chinese leaders have the flexibility to move forward, being more progressive moving toward democratization, human rights.

Yet I have heard that the President himself has stated very recently that he is not pleased with the progress that he sees in China. In light of all of that, can you tell us your current thinking, the Administration's current thinking, in regard to China?

Secretary Brady. It is my understanding that the World Bank had as a prospective series of loans about two billion dollars worth of loans to China. I think you said that $900 million had been approved. That is not—$800 million, excuse me.

We have voted for a total of $90 million worth of loans, which have been categorized very clearly as basic human needs. We have stated that we will be in opposition to loans which do not qualify as basic human needs, and we have made this point very clearly to Mr. Conable, not only on our own behalf but on behalf of those people in Congress who feel the same way, and there are a great many of them.

So I expect that that will be the order of the day. We do not control the World Bank, as you know. We have been able to muster sufficient support with regard to China so that the line of lending that we have outlined, which is for basic human needs purposes only, is one that has been adhered to. And I am hopeful that we will be able to continue that line, that the only loans made will be to meet basic human needs.

Mr. EDWARDS. I think that Barber Conable has said that by July 1st they expect to move about a billion dollars to China. Is that your understanding?

Secretary BRADY. It is my understanding that that is the World Bank's position. It is not ours.

Mr. EDWARDS. Well, this goes back to my point about the multilaterals. If we are putting the money into the World Bank and it is not our position, does that mean that we will be able to stop it from happening, or will it happen?

Secretary BRADY. I think we have stopped it from happening. That is the reason why we have only basic human needs loans going forward right now. That is totally a reflection of Administration policy and your policy.

We had a discussion with President Conable on this matter, and other loans which were about to be put forward have been slowed down until we can see what progress is made in China—exactly the kind of thing that you and the President have been talking about. So far it has worked.

Mr. EDWARDS. Thank you, Nick.

Dave, since I am not the chairman time limits do apply, and I yield back.

Mr. OBEY. Thank you.

Mr. McHugh.

Mr. McHUGH. Thank you, Mr. Chairman.

Mr. Secretary, welcome. Let me make two brief comments first and then ask you a series of questions.

ROSTENKOWSKI BUDGET PROPOSAL

First of all on the Rostenkowski plan, which you and the chairman discussed briefly, for what it is worth let me add my commendation that you are demonstrating some flexibility here. I think it is critically important that there are in fact negotiations between the Congressional leadership and the White House on a comprehensive plan.

And as you have indicated, while we may disagree with certain details of Mr. Rostenkowski's proposal, it is a comprehensive plan. To me that means it deals with three items which have to be dealt with if we are serious about deficit reduction, and that is defense, entitlements, and revenues.

Unless we do that, any plan that we are dealing with is simply inadequate. And Mr. Rostenkowski has proposed a plan which does all three and, while we may disagree, at least it is the basis for some negotiation.

So I am pleased to hear you say that the Administration is willing to talk about it, and I hope that results in seriousness on both sides, because otherwise we are continuing to defer what is a very serious problem.

ARREARS IN NICARAGUA AND PANAMA

On the MDBs, as you know, I agree essentially with your philosophy, but I do think the questions raised by Mr. Obey need to be addressed and there has to be some reassurance in this area, and I trust from what you have said and what you have done that you are trying to do that as best you can. But these questions are serious ones, as I am sure you recognize.

One of the perhaps more marginal questions, which I suspect can be a problem here as well, relates to the forthcoming request on Nicaragua and Panama. As I understand it, the Administration is going to be asking for money to help those two countries clear up its arrears with the IDB and perhaps the IMF.

It will inevitably lead to the question as to whether this is not an example of where American taxpayers are being asked to make good on debt owed by friendly governments to multilateral institutions, and if it is true in the cases of Panama and Nicaragua, is it not ultimately going to be true in other cases, such as the Philippines?

What is your reaction to that? I mean, are we in fact digging a hole here in terms of those who would raise questions about multilateral lending and the ultimate potential for U.S. taxpayers having to bail out some of these countries who have incurred excessive debt?

Secretary **Brady**. Well, if you are talking about the Nicaraguan support package——

Mr. **McHugh**. Yes, and Panama.

Secretary **Brady**. And Panama. There are in our programs—correct me if I am wrong, Charles—amounts which would be dedicated to arrears, but they are far short of the total arrears in those particular country cases. It is in some minor extent true that on a bilateral basis we are helping on that particular item. But it is the way in which you unlock the whole process, and we have to go forward with that.

Do you want to?

Mr. **Dallara**. All that I would add, Mr. Secretary, is that we see this process of clearing the arrears to Panama and Nicaragua as a multilateral process, and the United States will be working with these countries and with our allies to obtain additional support, so that the United States does not carry the bulk of the burden in the process, which, as the Secretary indicated, is so critical to opening the doors to multilateral lending to these countries.

Mr. **McHugh**. Well, I am not quarreling necessarily with the request. I think we should be responsive to the problems in both of these countries where, for different reasons, we have responsibilities to address.

But I do think it potentially raises some problems for us in terms of our defense of multilateral lending and debt burdens which have been incurred.

FUNCTION OF EUROPEAN BANK

Let me pursue one or two questions if I may on the European Bank, and it is possible that you cannot respond to these because negotiations, I gather, are still under way. In the World Bank and the regional development banks, as you know, there are charter provisions which say that loans shall be made solely on the basis of economic considerations.

Do you know if such a charter provision will be included in the European Bank's charter?

Secretary BRADY. I do not, but I could get that information for you.

Mr. MCHUGH. One of the reasons I raise that question is because there is discussion, as we have had today, about political considerations: Is there a functioning democracy in place? And obviously, I am not opposed to functioning democracies in Eastern Europe. I think we should be promoting those.

But I want to be clear as to whether or not this European Bank will be different in its purposes from the existing multilaterals, and if so in what respects. This is one question that arises in my mind based on the discussion we have had so far.

If it is going to be different, then I think we need to understand that.

Another area where there may be some differences, and perhaps you can respond now or later to this, is the nature of the lending. If I understand what you have said earlier, the lending will in the European Bank case be targeted, if not exclusively at least primarily, to private sector institutions, as opposed to governments?

Secretary BRADY. Well, that is correct.

Mr. MCHUGH. I am not necessarily opposed to this. I just want to be clear.

Secretary BRADY. I understand. But the reason your question is so clearly on the point is that in many of the other multilateral institutions we have stronger positions which allow us to have a major influence on shaping the loans going forward.

In the EBRD, it is quite clear that the European Economic Community will have 51 percent or more of the votes, and therefore it is inordinately important at the outset to get into the charter and bylaws of this institution clearly what it is that the institution can and cannot do.

In regards to the matter of infrastructure versus private sector lending, there will be, based on the present status of negotiations, limitations to how much can be loaned for infrastructure purposes and how much has to go to private sources by the bylaws of the bank. At this moment the preponderance, 60 percent, must go to the private sector.

Mr. MCHUGH. I think it makes some sense. I am not quarreling with it, but I did want to be clear, as clear as we can be at this point, on what that limitation will be. I gather this is still a matter of negotiation.

Secretary **Brady**. It is.

U.S. PRIVATE SECTOR INVOLVEMENT IN EASTERN EUROPE

Mr. **McHugh**. One of the questions which people are expressing some concern about generally is whether American private sector organizations are sufficiently involved or will be sufficiently involved in Eastern Europe. We hear that the Japanese, for example, are all over Eastern Europe. Western Europeans are beginning to be very active there.

To what extent, if you know, are American businesses becoming involved in Eastern Europe? This seems to be an opportunity for us. It certainly would be helpful to the Eastern Europeans in moving toward democracy and open markets. And of course, if the European Bank to which we contribute is going to be providing financial resources to private sector organizations, we would like to see Americans, American businesses, be on the receiving end.

Can you tell us at this point how much interest and involvement there is by American business organizations in Eastern Europe, and is it sufficient?

Secretary **Brady**. Let me step back. I am going to answer that question in one second. But my memory now recalls that, with regard to the EBRD as opposed to other multilaterals, there will be in the charter and bylaws the prescription that the loans are used to promote democracy. That would be different from the other multilateral institutions.

With regard to U.S. business, I think it is clearly going to be a slower proposition than it will be for European businesses. I have just come back from a four or five day swing through the foreign capitals, including Warsaw.

It is clear to me that in the initial instance the big push is going to come from the Germans, the French, Austrians, and to some minor extent from the British. I think that the level of investment from British private sources will probably be about the same as ours. We do not know that much about operations in the Eastern Bloc countries, and I think our influence in terms of investment will be slower than that of Germany, France, and other countries that are right there on the continent, that have close business ties, particularly I might say, Congressman, banking ties, because that is important.

The Deutsche Bank, the Commerzbank, the Dresdner Bank, banks in France, banks in England have a much higher preponderance of loans than U.S. banks, which—as opposed to Mexico where U.S. banks hold 33 or 35 percent of the loans—only hold something like three percent of commercial bank loans to the Eastern Bloc. So the natural business ties in the banking sector of our economy are much less.

Mr. **McHugh**. I can understand that about Western Europeans, but I understand also the Japanese are being fairly aggressive in terms of exploring possibilities at least in Eastern Europe. Is that correct?

Secretary **Brady**. I cannot speak precisely to that point. My overwhelming impression, both from the receiving end and from visits to Rome, Frankfurt, and London, is that a great part of this is going to come from Europe and that, although the Japanese will be there looking, I think they are somewhat in the same posture we are.

IMF GOLD SALE

Mr. McHugh. I have a series of questions on the IMF which I suspect I do not have time to ask. But if I may, let me just ask one more, Mr. Chairman. I think our Administration has requested or suggested to the management of IMF that a certain amount of gold stock be sold to enable debt to be repaid by some of the lower income countries.

What is the status of our request to the IMF in this regard? And perhaps you can briefly indicate whether this would be precedent-setting and why precisely you have made this request?

Secretary Brady. Thank you, Congressman. This item, this matter, was discussed thoroughly with each of our G–7 partners in Europe on my recent trip. The theory behind the gold sale proposal is a concern for the level of arrears in the IMF, which has built up over the last several years to a point where they are much higher than they should be.

We think it is important, it is critical in fact, that the IMF continues to be the anchor to the world financial system that it has been in the past, and an anchor that goes to the bottom, not a sea anchor, but an anchor that goes to the bottom and grabs the bottom. There needs to be a centerpiece to the world financial system that is not compromised by the interaction of international geopolitics.

As a result, we have taken the position in the IMF negotiations that at the same time we discuss what level of increase there should be regarding the quota increase, that there also should be a determination of how we are going to handle those arrears.

We have put forward a proposal which in its early days was not necessarily widely received, but which after this visit and the Treasury's work in the negotiation process has become much more acceptable. We have proposed that an amount of gold, corresponding to the gold subscriptions of members with arrears, should be mobilized, and the proceeds placed in a fund where it can earn interest. In the meantime, these countries would adopt solid economic programs that would enable them to earn their way back into a position where they can tap the funds generated by the gold mobilization and eliminate their arrears.

Initially it was not widely received, and I think that is probably because of the emotional character that gold has in the world. As we explained our position and explained that it was an attempt to deal with the arrears problem, I found that almost everybody that listened to that explanation said: Hey, that is not a bad idea.

So I think that it has enhanced standing now. What we have said is that, if you gentlemen, our G–7 partners or others in the IMF, can come up with a better process of dealing with arrears, we would be glad to look at it. But so far there has not been one.

Mr. McHugh. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Mr. Obey. Thank you.

Mr. Porter.

PRIVATE SECTOR INVESTMENT THROUGH IFC AND EBRD

Mr. **Porter**. Mr. Chairman, thank you very much, and let me thank you and the gentleman from California for allowing me to ask my questions. I have a noon speech, Mr. Secretary, so I asked if I could go out of order.

The International Finance Corporation (IFC) is on the ground in Eastern Europe, at least in some of the countries, Mr. Secretary, and Eastern Europe itself is putting trade and investment at the top of their priorities in their wish lists. AID is not on the ground as yet, and the European Bank for Reconstruction and Development is going to take some time to set up its operations.

Should we not be emphasizing private sector investment through IFC more heavily than we are in approaching help for Eastern Europe?

Secretary **Brady**. Well, we are emphasizing the private sector through the IFC. We are also doing it in our negotiations in the EBRD in a very particular and strong way.

Mr. **Porter**. Well, it seems like we have kind of shifted our emphasis, Mr. Secretary. We originally were going to take 8½ percent. Now I understand we are thinking of taking 11 percent of the European Bank's shares. That would mean a large increase in outlays under Title I, about 20 percent, and we will still not have enough direction there, and probably they will be emphasizing the kind of approach that maybe the Inter-American Bank emphasizes, government to government infrastructure type loaning, when really we ought to be trying to get into the private sector much more.

Secretary **Brady**. Let me just say two things. With regard to the newspaper story that referred to the 8½ to 10 percent as though it was some major item, that is just totally inaccurate. We have always said we were talking about a range of 8½ to 10 percent.

It has not been a matter of great concern to either the Europeans or ourselves. We just have not fastened down on the point. It is about ninth in the list of items that is being discussed. So I think that story contained emphasis—I do not know where it came from—that is just inaccurate.

With regard to whether it is 8½ or 10 percent, you are right on the point. What we have to do as we participate in these negotiations is make sure that the prospective institution's articles and bylaws contain the principles that we espouse: free enterprise and democratic capitalism. This is important because we will not have blocking power in this institution if we join it.

Mr. **Porter**. In the meantime, IFC is really the only way to get the money into the private sector through a government program, rather than through private investment.

Secretary **Brady**. That is right.

Mr. **Porter**. Is that right?

Secretary **Brady**. Yes.

Mr. **Porter**. And you would emphasize that very heavily?

Secretary **Brady**. I would indeed.

MULTILATERAL DEBT-FOR-NATURE SWAPS

Mr. **Porter**. Mr. Secretary, last year we passed legislation that calls on the Treasury to foster debt-for-nature swaps through the World Bank and other multilateral lenders. Can you tell me what progress has been made in your Department in facilitating these types of exchanges, the debt-for-nature swaps that were contained in that legislation?

Secretary **Brady**. Well, as you are I am sure well aware, Congressman Porter, we have an executive director in the World Bank and a great part of his day is spent emphasizing to Bank management the particular importance that we attach to environmental impact statements. And although the progress has not been as fast as we would hope, it has been very direct, very particular, and very obstinate on the part of the United States Treasury in trying to further some of the environmental reforms that you and others have talked about.

When we get to this subject, because of the effect of these impact statements and other environmental requests on debtor countries, we get plenty of opposition. But I can guarantee you that we are pushing very, very hard and have used whatever leverage we could muster to get this job done.

Mr. **Porter**. I understand that the World Bank and IFC are involved in arranging a large debt-for-nature swap in Paraguay. Are we involved in any of that in an active way?

Secretary **Brady**. I would ask Charles Dallara to answer that question, please.

Mr. **Dallara**. Yes, Mr. Porter, we are very actively involved. We have been working with the Nature Conservancy, the World Bank, and USAID to try to move this debt-for-nature swap forward.

It is my understanding that there have been a number of stumbling blocks to this, including some concerns of the government, but progress is being made now and we hope that the basic objective here of protecting the tropical rain forest in Paraguay can be achieved through implementation of a debt-for-nature swap.

Mr. **Porter**. Thank you.

ADDITIONAL CAPITAL FOR IFC

Mr. Secretary, finally, Barber Conable I think believes that unless we can raise additional capital for IFC, that their role in Eastern Europe is going to have to be constrained, and he is supporting raising the capital for that purpose. What do you think about that?

Secretary **Brady**. We would have to check on that and get back to you. We do support the IFC. It is an organization that does carry out what we want to see done. But I cannot tell you precisely the answer to that question.

Mr. **Porter**. Mr. Secretary, thank you for your leadership on the environmental questions. You certainly have been very much out front in putting it at a high priority for your Department and also for emphasizing the private sector in approaching our responsibilities in Eastern Europe. Thank you very much.

Mr. Chairman, thank you for letting me go out of order. And Jerry, thank you.

Mr. **Obey**. Thank you.

Mr. Coleman.

COMMERCIAL BANK DEBT RELIEF IN MEXICO

Mr. **Coleman**. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. I recall last year when you testified before the committee and you talked about the necessity for a departure from the way we had done things concerning debtor nations. I think that the past year has seen great change because of the Brady Plan. And I am sure that you also have heard and are aware of the criticisms of the Brady Plan over the months.

But as one member of Congress that has followed fairly closely your efforts and those of the Brady Plan, I certainly think that the results, and particularly as they relate to Mexico, are not all bad. Indeed, I think that the debt relief that Mexico can enjoy as a result of those efforts, along with the assistance that we had in the Paris summit from other countries as well, and the MDBs, will prove to be of great benefit to this country in the long run.

Let me ask you about the private commercial banks and that debt. You said on page 4 of your statement that: "99 percent of the 450 banks with exposure in Mexico chose to participate through one of the three options."

Could you tell us about the one percent? You say in your statement that they are not a free rider—I mean, that there are no free riders. But there were obviously some. Which ones are those banks?

Are they United States lending institutions mainly, or what are they?

Secretary **Brady**. It is a very, very, very minor point and I cannot answer, unless Mr. Dallara can, as to who they are. It did not matter, they were so small.

Mr. **Dallara**. That is certainly right, Mr. Secretary. My memory suggests that there was one bank, actually—99 percent, it really should probably say 99.9 percent—one bank, a small U.S. bank, that chose to not participate, and it involved in part a dispute over whether or not the bank was still holding any claims against Mexico. I think the bank said that they did not, the money center banks said they did.

But certainly this is an unprecedented record in terms of virtually no free riders.

Mr. **Coleman**. Well, as I said at the outset, I think that is laudable. I think you broke new ground here. I think you made some progress.

With respect to that, I think there has been a question about whether or not the debt which Mexico still owes to both official and private creditors is fully guaranteed. I think we continue to see that terminology used from time to time. I think your testimony here indicates that you believe it is reasonably well guaranteed.

Secretary **Brady**. That is correct.

OFFICIAL DEBT REDUCTION

Mr. **Coleman**. Well, let me ask you about the official debt issue. We have heard testimony from others before this committee throughout the last year who refer to official debt as a component of the debt overhang in a number of countries. I recall that Professor Sachs used the example of Poland as one of those instances. There are other countries in this hemisphere as well, as you know, where debt from official sources constitutes a large share of the principal.

Do you see the reduction of official debt as a more difficult problem? Will it be harder to achieve than the debt that we have been able to achieve reductions in from private sources?

Secretary **Brady**. Well, I do not know whether it will be harder to achieve or not. The basic strategy with regard to the plan that we put forward a year ago was to deal with the junior debt. That is generally speaking the place in reorganizations, whether they are governmental or corporate, where you start, because the senior debt, the official debt, has first claim.

So the approach underlying the new debt strategy was to try and deal with the commercial bank debt. In the case of Mexico, certainly, which was the first one on our plate, dealing with commercial debt would provide a big part of the solution.

When you get to a country like Poland, that is not the case. Poland has a much higher degree of official debt. As you know, there was a Paris Club rescheduling for Poland which rescheduled all payments due on official loans in 1990, including both principal and interest. It is my understanding that the same will be asked of commercial banks and, since they involve banks outside the United States, I cannot tell you exactly how that is going to come out.

Mr. **Coleman**. I think it may recall a suggestion that has been made by Senator Bradley, that perhaps we would do well to consider whether or not it would be important to have the multilateral lending institutions be brought in, even moreso than perhaps they have been. I am not saying that they have not, but maybe as financing institutions they should be brought into those kind of negotiations.

Secretary **Brady**. I think the one thing that you have to remember, sir, if I can interrupt you, is multilateral lending institutions get enormous banking leverage out of the fact that they enjoy preferred credit or status to get paid back. If you ever get to a point where their debts are wiped off the books, then you have lost the leverage that a multilateral bank provides.

In other words, member countries put up, say, five percent of the equity and the other 95 percent comes from private lenders who assume repayment of MDB loans. This arrangement yields enormous leverage. Writing down MDB official loans would seriously jeopardize this arrangement. You could end up with an international aid agency on your hands where you have, instead of a 19 to 1 leverage factor, a 1 to 1.

And if we ever get to that point, we are in trouble in my opinion in terms of doing what we do to leverage private capital markets.

Mr. **Coleman**. I recognize that. I think that when you suggested a second ago, however, that we have foreign banks as well, that indeed those institutions with that knowledge, and with that capability of leveraging themselves in those various countries, would be beneficial.

INTEREST RATE REDUCTION

Let me then ask you about the prospects for future agreements. There are some 46 countries which are generally described, I think, as being eligible for consideration under the Brady Plan or for general provisions of the Brady Plan. You can correct me if that number is way off base.

But I read that Venezuela, for example, is approaching an agreement in which there might be a temporary reduction in the rates of interest payable on obligations to the banks. Would this be something new, a temporary reduction? Is that something new on the menu of options, as we call it?

Secretary **Brady**. Well, each of these has different conditions attached to it. Some of them are reductions which continue over the life of the bond, some of them are not. With regard to Venezuela, I would ask Secretary Dallara.

Mr. **Dallara**. Thank you, Mr. Secretary.

There actually were some provisions in the Mexican agreement that provide in some circumstances in the late 1990s for some return of interest rates to a more market-based rate. So this would not be entirely new, and indeed that is one of the elements of a very innovative menu which is now being negotiated between Venezuela and the commercial banks.

IMPORTANCE OF MULTILATERAL INSTITUTIONS

Mr. **Coleman**. Well then, finally—and it is too bad Mr. Edwards had to leave—I could not disagree more with his statement that it does no good for the United States to help through multilateral institutions and loans, because I think just from your testimony today we have evidence that that is not the case at all.

Finally, even if you do not agree with the discussion that has gone on or the statements you made, how in the world is the United States going to go it alone anyway on bilateral matters? The total amount of dollars that we are able to push through as one nation will wind up being very inadequate.

So I thank you, Mr. Secretary, for your testimony. I hope we will continue to work together, particularly with countries in this hemisphere. I hope that we do not neglect Latin America as all of this nation's vision, I think, is sometimes turned towards Central and Eastern Europe.

Thank you, Mr. Secretary.

Mr. **Obey**. Mr. Lewis.

Mr. **Lewis**. Thank you, Mr. Chairman.

ROLE OF MULTILATERAL INSTITUTIONS

Mr. Secretary, it is a pleasure to have you with us today. I would like to [initially at least partially] endorse the praise extended to you by Mr. Coleman. I agree that while the Brady Plan provided a framework for beginning to move in the direction of restructuring some of our international debt problems, through the Brady Plan you have moved us even further in that direction.

In this series of hearings one of my intentions is to suggest to Administration officials who come before us that the current challenges we see in our shrinking world is the reality that America has a very significant role to play in the problems of that world. The public, especially constituents of the chairman and my own asks: What are you doing overseas?

They presume we are spending 15 or 25 percent of the budget on foreign assistance. You and I know that the dollar amount really reflect a percentage as small as one and a half to two percent. If we are going to provide leadership in the world in the future, we must then use multilateral institutions to effectively leverage that money.

I would submit further that, because of the radical changes taking place in the world, it is time for all of us to consider whether the United States should not be playing a more significant role in terms of dollar contributions to that entire mix.

The chairman and I also have another experience in common, The Chairman comes from Wisconsin, where the farmers early on found that they could not produce all they needed to produce by their own capital alone. So early on they began developing a relationship with financial institutions. They clearly established that they were part of that American tradition; that one's word is one's bond a very important item that relates to people who are in politics. You give your word, you sign a contract, and you keep that word.

What we are talking about here in restructuring international loans is restructuring or allowing a means whereby those countries can hedge on their original commitment.

That is a very, very serious decision. It does not just affect inanimate banks. It affects people who have invested in those financial institutions; it affects our depositors in a radical way. And so, we are about serious business.

Generally I would agree with the chairman's commentary as to your analysis of the Costa Rica model. I personally think the Philippines is a model that we ought to review with care to ensure that we do not make some of those mistakes again as we try to solve problems in other parts of the world.

MEXICAN DEBT RELIEF AGREEMENT

The case of Mexico, though, I think is still to be analyzed. I had the privilege of traveling with the Secretary for the signing of that debt agreement, and what is taking place in that country is truly phenomenal. Perhaps I cannot help but mention the chairman's comment about Mr. Colby's testimony, in which he called one billion out of $9 billion a small piece of that package.

I would like to give you the opportunity to elaborate on your earlier response. The fact is that it is only one part of the $40 billion Mexican debt problem and one billion out of $9 billion is over ten percent of that piece. When you combine the whole package, we see that a great deal of relief has been given to Mexico.

Frankly, Mr. Secretary, I would like to hear for the record your comments on this matter.

Secretary **Brady**. Thank you, Congressman Lewis.

On a more general level, I wish everybody could have been with us the day that you and I were together in Mexico, because in spite of what I hear in the way of questions about the Mexican debt, the entire establishment of Mexico turned out that day. Some 400 to 600 officials of the government and leaders of the private sector sat in the courtyard of the palace where President Salinas' offices are in observance of what they thought was a significant event.

My simple mind tells me that if the banks did not do as much as they should have, and I certainly was in the forefront of trying to get them, to do more—what were all these people doing there saying, good work, this is what we wanted?

What has happened since? Well, what has happened since is that interest rates have decreased, flight capital has begun to return, the Mexicans have stayed with their commitment. They have sold Aeromexico, they are in the process of selling a major copper mine and the telephone company— all these things to private investors in their own country and foreign investors. So capital is coming back.

Have we done all that we wanted to? No. Have we done something significant? Yes. Will the basic principles be followed elsewhere? Of course.

So we will just have to keep laboring and working away. Each of these deals will always have something to it that somebody else will feel could have been done better, and that may in certain circumstances be the case. But I think an enormous cloud was lifted off the horizon, and I could give you a list of details about what debt was removed and what was not.

In sum, I want to tell you that the Mexicans think that a great burden has been removed from their financial future.

Mr. LEWIS. Mr. Chairman, I do not suggest that there is any linkage, but it is phenomenal to see what is taking place in terms of that economy. Interest rates have dropped from nearly 200 percent to the neighborhood of 20 percent presently. The new government is selling off public sector holdings, stimulating the private sector, encouraging investment— the kinds of activities that will make a real long-term difference.

LOANS TO CHINA

Shifting to the MDBs, you know, Mr. Secretary, that I have not always been the greatest supporter of some of the activities of the MDBs, Over time I have found that the chairman and I have not disagreed about the value of leveraging our money.

From time to time I may have overemphasized the need for conditionality in terms of the way that money is delivered. Nonetheless. I continue to feel that conditionality is a significant element in the use of MDBs to make a difference in the world.

Let me mention the question I have about to China. I have talked to the President of the World Bank, Barber Conable, and suggested that I probably was not going to have any strong negative reaction to initial humanitarian loans.

You described them as loans in the amounts of roughly $80 million, maybe a little more than that. But there are larger loans in the offing, and it is suggested by some that those loans will go much beyond humanitarian loans and may involve significant contributions to infrastructure development.

This is not bad if there is some reasonable condition that there will be development of individual opportunity, humanitarian development, and maybe even private enterprise. But to talk about moving in the direction of a billion dollars concerns me because we often have put conditions on such lending; or lent our voice to conditions either too softly or too late.

Regarding China, I would like to know whether the United States would be willing to do more than express its concern about loans that go beyond humanitarian aid to China without conditions. Would we go so far as to direct our representative at the World Bank to vote against such sizable loans as they are proposed in the future if the loans go beyond humanitarian purposes without serious conditionality?

Secretary **Brady**. Well, each one of these loans is different, as you are well aware, Congressman. We have been in exact compliance with that line of thinking up until this point.

Obviously, the President's feelings will change based on circumstances in China. At this particular point in time as Chairman Obey or somebody else referred to the fact, progress is hard to determine. Therefore, we have told the World Bank that our support goes only at this time to basic human needs loans. And that is where we are.

Mr. **Lewis**. Frankly, I think that is where you should be at this point in time. But we will, I am sure, review that position as we measure progress in dealing with that country.

One of the items I wanted to mention for the record is the IDA authorization. The soft loan window of the World Bank is up this year. I think it is important for the Administration and people at the World Bank to know that some of us are looking at that as we get responses to our concerns regarding lending flows that may go to China and the kinds of conditions that we think are important in terms of progress in countries like that.

Secretary **Brady**. I appreciate that, and I appreciate your support for the multilaterals as well.

DEBT FORGIVENESS

Mr. **Lewis**. I must say that, Mr. Secretary, that support has been shifting. Very much is linked in my mind's eye to the kind of progress we make in impacting those countries' attitudes about their macroeconomic view of the world, and their own condition.

While the United States has done some readjusting of loans elsewhere, we have been very, very hesitant about the business of forgiving loans. We have made some readjustments of loans to Israel. We have only forgiven loans, I think, in sub-Saharan Africa.

There has been a lot of talk in the committee, however, about official debt in places like Poland. Of that debt, Germany has a great deal of it—$27 billion of official debt. We have about two percent.

Do you think there is a chance that we will be looking at loan forgiveness in some of those countries. Will that be a part of our policy? If the answer is partially yes, I would like to know if you considered also including "debt for development" as a means of advancing the contribution we can make technologically through our universities?

Secretary BRADY. Well, in the case of Poland, of course, we were part of the Paris Club rescheduling for 1990. That is not debt forgiveness but it is debt postponement, and I think it says, let us take one year at a time and a shorter period of time and see where we are and keep going.

My feeling is that once you have done that for a year, you will be able to show that progress is under way.

Mr. LEWIS. Does that mean that a part of your thinking may very well be participating or encouraging others to consider outright forgiveness?

Secretary BRADY. Well, we are part of the Paris Club negotiations. With regard to what was done in Poland by the Paris Club, that is a step that we supported.

The whole area of official debt forgiveness is one, obviously, that is raised with regard to the new debt strategy as well. It is quite clear that when you add together the figures with regard to Mexico and elsewhere and you include official debt, the magnitude of the problem intensifies. To a large extent the issue of official debt is unaddressed in the new debt strategy.

As I said to the chairman, I would call the new debt strategy a way station. It seems to me that what you have to do is clear out or make progress on the commercial bank debt and then you can get to the second stage. I do not have a clear view as to what we ought to do now, but I think it is something that has to be determined this next year.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. OBEY. Thank you.

Mr. Gallo.

EXPORT-IMPORT BANK ACTIVITIES

Mr. GALLO. Thank you, Mr. Chairman.

As you get down the list in seniority, you also lose a lot of the questions. But you have the opportunity of not having to ask the question and get the answer before.

Secretary BRADY. From what I know of the people in New Jersey, you are going to be around a long time, Congressman.

Mr. GALLO. Thank you.

Let me say that one area that has been a concern is the ability of American companies to compete for international trade opportunities and how we can better bring about a more positive situation. There are a number of areas that are available to American business, but one is the Export-Import Bank. This year—the year before it was zeroed out the request has been increased to $500 million.

That is, as I understand it, about $115 million less than last year's level. Other countries are already taking advantage in Eastern Europe of the opportunities, or at least preparing for those opportunities.

It is striking that Japan and its Export-Import bank funds it by $4.4 billion versus the United States, using last year's figures, of $615 million. If there is one area that I think can be most helpful, at least to the businesses that I have talked to, it is increasing those areas such as Ex-Im that are going to develop the proper atmosphere for American involvement, along with multilateral agreements and bilateral agreements.

So I would like to know how you feel, Mr. Secretary, in regard to the effectiveness of the Export-Import Bank and whether or not you think it has been helpful or plays a major role in developing our trade relations and opportunities for U.S. business?

Secretary **Brady**. Well, we support the activities of the Ex-Im Bank. John Macomber, who is an old friend of mine, is a very, very wise and experienced businessman, and I think he will do an excellent job.

Regarding the crossfire we are in with regard to the World Bank, we wanted that bank to support the business opportunities that are available to our businessmen; at the same time, we do not want to get into a bidding contest of subsidized business, of business contracts being subsidized by government support.

So it is a question of supporting the legitimate wants and needs of our business at the same time as we try to settle GATT and some of these other trade issues; i.e., that we do not do what we have advised and strongly advised our trade partners not to do, which is to get into some kind of a subsidized trade war.

I think we have got it at the right level.

Mr. **Gallo**. Let me add that one of the problems that I see, and it has been vivid the last couple of months, is with regard to the $100 million war chest. That war chest was used to, for lack of a better term, level the playing field with other countries where it has been obviously subsidizing the industry to get a particular contract or contracts.

Most notably, I had an experience with competition from France, and without the availability of leveling that playing field, namely in the area of finance, I had two companies that had the lowest bid, had the best product, and did not have the financing that was demonstrated by these other countries.

Now, I do not mind a little subsidy when it makes us a competitive force. If we take the attitude that we are going to allow other countries to get directly involved in the finance end of it and make it so appetizing that it benefits their business versus ours, then I think we have got to wake up to the fact that we had better get competitive, too.

I felt that the $100 million war chest was one way of utilizing it on a very limited basis. Do you feel that that—by separating it, we are getting directly involved through the export-import end of subsidizing the U.S. businesses?

Secretary **Brady**. Well, I think the examples that you have cited are ones that are repeated all over this country, and again I can only go back to the war chest, which should be used to indicate that we are not going to sit and watch this kind of action take place willy-nilly.

By the same token, we are caught on the dilemma of trying to make sure our companies have enough wherewithal to secure the contracts; at the same time, we are the leaders in the world, trying to get the principle across that we do not want a trade war in subsidies to break out, because that will undermine all of the improvements we have made in GATT and elsewhere.

I think it is a question of judgment and size.

JAPANESE SUPPORT IN EASTERN EUROPE

Mr. **Gallo**. Just one final comment, and it is more of a statement than a question. It has come to my attention that the Japanese will be spending for the next three years in Eastern Europe, in Poland and other countries in Eastern Europe, over $500 million per year. It is already committed.

So they are going to have a substantial stake in this, and I think it is proven where the United States business has had the opportunity of getting in there and doing its thing, similar to in the Soviet Union where a hamburger franchise has become very successful, there is no one that is going to go in there and take that success away.

So early intervention in these countries will bode well for the future of our economy, and also for lowering our trade deficits.

I thank you, Mr. Secretary.

Secretary **Brady**. I think, Congressman Gallo, that there is another side to your reference to the Japanese support. That support is actively sought after by the Administration with regard to the Japanese, and we have asked them: Look, we do a lot in the defense area, and much of it is defense of the area of the world that is important to you; now you can pitch in and help on some of these areas that are turning to democracy.

We are actively asking them to use some of their excess funds to do part of it. So that too is part of the solution.

AUTHORITY FOR ISSUING MEXICAN ZERO COUPON BONDS

Mr. **Obey**. Mr. Secretary, just a few other questions before we adjourn. I want to go back to the Mexican plan. I think the psychological effect of the change and dedication of the Mexican government to do something aggressive to deal with its own past misguided policies are very much at the center of the improved situation that we have in Mexico.

To the extent that the Brady Plan contributes to that, I think it deserves applause. I do not think we should assume the banks have indicated their willingness to do what they ought to do, not only in Mexico but in other parts of the hemisphere.

I have a specific problem with the Mexican sale, I must confess. I want to ask you about the zero coupon bonds in the Mexican package. As you know, this committee and this Congress have been readily lectured by the White House about the constitutional role of the President and Congress in foreign policy. Last November we spent many hours negotiating with the White House over the antileveraging provision, which simply said that this Administration could not encourage or reward countries with foreign assistance funds for taking action which would be illegal if they were taken by an American official.

On the 23rd of January, the Wall Street Journal ran an editorial referring to your Under Secretary as "Ollie" Mulford. I do not agree with that designation.

Secretary **Brady**. I must say, I just have to interrupt you. I think that editorial was a personal attack on a loyal public servant and I object to it emphatically.

Mr. **Obey**. Well, if I could finish, what I was trying to say is I have a great deal of respect for Mr. Mulford and I do not agree with the characterization therein.

Nonetheless, I do have a problem with the action taken by Mr. Mulford, because that describes what appears to be an action of the Treasury which effectively appropriates about $350 million of public money without Congressional approval. I am bothered by the precedent that is set in the implied grant of authority to the Department and the possibility of a violation of the Congressional power of the purse and the Anti-Deficiency Act.

With the exception of the Treasury position, I know of no one else who has focused on the issue—Wall Street analysts, economists, independent financial analysts—who disagree with the assertion that the U.S. sale of those bonds was cut-rate and below market prices. As one member of the Congress said, a back-door rescue of the Mexican debt package.

I think I have an obligation as a member, especially as a member of the Appropriations Committee, to point out that there exists no authority in law for anyone to provide the use of public moneys without the specific approval of the Congress. I want to ask you, what specific legal authority is granted to the Department that gives it the authority for selling assets at below-market prices?

Secretary **Brady**. Well, first of all, we did not sell the assets at below-market prices, so that the answer to that question is moot in my opinion. There are a number of different ways of looking at the fixing of the zero coupon price with regard to Mexico. Certainly one of them is that we did just exactly that same way of fixing it in 1987 when we had a similar zero coupon transaction, and it was contemplated by the President of Mexico and his Finance Minister that they would be treated the same way at this particular point in time.

I am one that feels that when you have that kind of a precedent, and that no questions about it were raised, then you stay with such an arrangement.

So there was no need for an understanding at the early part of our negotiations with Mexico to make arrangements in any other way than the way that we did it.

With regard to the part of your statement, Mr. Chairman—about nobody coming forward—I would be glad to supply you with a letter to the editors of the Wall Street Journal by somebody I have never met, never heard of, do not know, who I think has a lot more expertise than was shown to me in a one-shot rather biased editorial.

Mr. **Obey**. Let me make this clear. I never defend the editorials of the Wall Street Journal. [Laughter.]

I regard the Wall Street Journal's news pages to be among the great news pages of the country. I wish that the editorial page reflected that same intellectual quality. I do not think it does.

And I do not want to defend their attack on Mr. Mulford, who I regard as being a first-rate public servant. I personally like the mustard that Mr. Mulford demonstrates when he deals with the commercial banks, for instance.

Secretary **Brady**. I do, too. I appreciate your comments.

Mr. **Obey**. Nonetheless, even from the least likely sources, one can often obtain at least a kernel of fact. With respect to that editorial, while I do not appreciate the personal attack, I do think they raise a valid point about the valuation of those zero coupon bonds.

Secretary **Brady**. Well, Mr. Chairman, I can only respectfully disagree. We spent a lot of time on this item. I would be privileged to spend any amount of time that you would like to go through it in its details.

I will send you as soon as we get back a letter to the editors which refutes the editorial in rather precise detail, instead of personal aspersions. And I can also provide you, if you will, commentary from the banks involved, who were on the scene and know the facts of the situation, not some wild supposition.

Mr. **Obey**. Well, let me ask you, why was this device not used in the case of the Resolution Finance Corporation?

Secretary **Brady**. Well, because there was a different set of circumstances involved and we came up with a different set of conclusions in that particular case, which is spelled out in an enormously complicated memorandum.

The matter of zero coupon bonds——

Mr. **Obey**. Do you believe you have the legal authority to do that with that corporation if you decided that was advisable?

Secretary **Brady**. I believe that we have the legal authority to make the determinations we did, since in my opinion in no sense was there any subsidy granted.

Mr. **Obey**. Well, I will be happy to see your response to the editorial. I have to say, I think that is a serious question.

Secretary **Brady**. It was not my response. It was somebody else's response.

Mr. **Obey**. Fine. But my point is you are providing it as a response to my question.

Secretary **Brady**. Oh, excuse me.

Mr. **Obey**. I am still looking for the specific authority you think the Treasury Department has to take an action which, at least in my view, is indirectly an appropriation of public funds or is the incurring of an eventual obligation by the Treasury, without a specific acceptance of that by the Congress. And to me that is a quaint way to do business.

Secretary **Brady**. I agree with that. I do not think that took place.

Mr. **Obey**. I will be happy to take a look at your rebuttal.

[The information follows:]

THE SECRETARY OF THE TREASURY
WASHINGTON

March 16, 1990

The Honorable David R. Obey
U.S. House of Representatives
Chairman
Subcommittee on Foreign Operations and
Export Financing
2462 RHOB
Washington, D.C. 20515

Dear Dave:

In response to our discussion of the Mexican Zero Coupon pricing decision during my recent testimony, I am sending you some relevant material. This includes a letter written to, but not published by, the Wall Street Journal from Louis Crandall, a former New York Federal Reserve Economist and a frequent commentator on the Treasury market. I have also included several articles that appeared in other journals which supported our pricing methodology.

I hope these materials will be helpful to you and I look forward to discussing any other questions you may have.

Sincerely,

Nick

N~~icholas F.~~ Brady

Enclosures

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Mr. Robert L. Bartley
Editor
The Wall Street Journal
200 Liberty Street
New York, NY 10281

January 31, 1990

Dear sir:

Your January 23 editorial on the zero-coupon bonds to be issued by the Treasury to Mexico misses its target. You are certainly correct to argue against hidden subsidies in general, but the transaction in question seems clean. Your detailed charges deserve a detailed reply.

The whole question turns on which benchmark to use in setting the rate on the new zeros. Your choice is the yield on 30-year Treasury STRIPS, the synthetic zero-coupon bonds created by the market out of conventional Treasury debt. This is a natural starting point, but there were good reasons for the Treasury to move beyond it. Furthermore, the Mexicans would have had good reasons to be aggrieved had they been forced to accept the distorted STRIPS yield. These reasons depend on the complicated nature of the STRIPS market.

STRIPS differ from the Mexican zeros in the way they are created. The Treasury does not sell STRIPS directly. Instead, it allows the market to create the zeros by breaking one conventional 30-year bond into the 61 discrete interest and principal payments that make it up. The relationship between those 61 separate zeros and a single conventional bond obviously creates a complicated "joint pricing" problem, especially when the prices of all other strippable bonds have to be taken into account as well. The market price of 30-year STRIPS is determined by the "cost of production" -- the cost of a conventional bond less the value of all the shorter pieces of the package. The STRIPS market is not a simple textbook case of supply and demand that would qualify it as the benchmark for a private placement of original-issue zeros.

The solution the market has found to this "joint pricing" problem creates anomalies. The STRIPS yield curve slopes sharply down at the very long end. On January 5, virtually all STRIPS maturing between 5 and 25 years from now yielded more than 8%, while the handful maturing in 28 or 29 years yielded as little as 7.75% to 7.80%. This means one of two things: (1) either investors have firmly held convictions that interest rates are going to fall sharply between the year 2015 and 2019, or (2) there is a quirk in the market that could be ironed out only if someone were willing to hold onto the necessary arbitrage position for the next quarter-century.

This is possible because the Treasury does not sell STRIPS itself -- it simply allows the market to create them. The market cannot create more of the lower-yielding 30-year zeros without spinning off more of the higher-yielding shorter STRIPS in the process. The artificially low yield on 30-year STRIPS is not a rate at which the Treasury could borrow in the market. If the Treasury were to sell 30-year zeros by themselves, without bundling them with 10- and 20-year "loss-leader" zeros in a conventional bond package, the price of the 30-year securities would plummet -- and their yields would rise. (Among other things, the yield on a straight Treasury 30-year zero would be higher than the yield on 30-year STRIPS because the former could never be rebundled as a conventional bond, a valuable option for which investors will sacrifice some yield.) The more sensible rate that the Treasury eventually picked for the Mexican deal recognizes all these differences.

The real point of asking whether the Treasury demanded too low a yield on the Mexican zeros is to determine whether U.S. tax-payers are worse off as a result. The only place to answer this question is the conventional bond market, since that is the only arena in which the government currently borrows. When the interest rate for Mexico was set on January 5, no conventional Treasury security maturing in more than six months offered a return as low as the 7.75% rate that you argue that Mexico should have accepted. And every long-term bond maturing in ten years or more offered a yield above 8%. The 7-year note that the Treasury sold just a week later averaged 8.03% at the auction. The 8.05% yield on the Mexican zeros seems perfectly reasonable relative to the U.S. government's regular borrowing costs.

What really seems to have happened in this case is that the Treasury had to choose between two imperfect benchmarks, and chose the one that penalized neither borrower nor lender. The Treasury did not waive the eighth of a point "service charge" that it assessed Mexico for creating zeros. This charge netted more than $100 million in direct underwriting fees for the U.S. government. I wonder, did Secretary Brady insist on those sorts of commissions when he worked on Wall Street?

Yours truly,

Louis vB Crandall
Chief Economist
R. H. Wrightson & Associates, Inc.

IFR International Financial Review

LDC Finance

Bad press throws a shadow over Mexico deal

Bankers, commercial and investment, are appalled at a series of articles and editorials by an influential US newspaper maintaining that the US Treasury's sale of zero-coupon bonds as part of Mexico's recently completed financing plan was a US$350m "bailout" by US taxpayers. The issue is important – a Washington lawyer has threatened a lawsuit to block the Mexico deal and there are rumblings that the US Congress, which is always as ready as lawyers to latch onto a high-profile issue, may hold hearings on whether the Treasury granted illegal aid to Mexico.

Commercial bankers and Mexican officials, who have closed the $400m financing gap between new money pledges and what they need to buy the zeros, are equally upset at the claim that the supposed "bailout" represented the closing of a far larger gap they say didn't exist by the time the financing was closed.

"These stories are way off the mark," one investment banker who informally advised the Treasury on the zeros, said. "If anything, you could claim that the Treasury got a 12 basis point advantage in that the yield to Mexico on the zeros in question is below what they would have to pay in the market."

The bankers were referring to a series of articles in the Wall Street Journal claiming that the Mexican deal cost the US taxpayer US$350m. Mexico is receiving 8.05% minus a one-eighth of one percent fee, or an effective rate of 7.925%. The rate was based on the average market rate for 30-year Treasuries on the three days to January 5, which was 8.05%. The benchmark in setting the price was the formula the Treasury used on zeros sold to Mexico in 1987 to collateralise a debt-reduction scheme put together by JP Morgan.

The Journal maintains that Mexico should have got 7.75%, which was the rate for the same three days on outstanding strips. They say the difference on US$33bn of bonds (the actual number is $35bn) amounts to a US$350m subsidy, or foreign aid that only Congress can authorise. "Their experts used the rate for the stripped market," said an investment banker who was not connected to the deal but who followed the zero issue closely. "That is wrong, because the strip market is a derived market and a new issue is based on the coupon market."

The newspaper based its view on the fact that the strip rate was used as a benchmark for a US$4.5bn issue of zeros last October that Reconstruction Funding Corp (Refco) will use as collateral for borrowings in the US S&L bail-out. But, given the cost to US taxpayers of that bail-out, estimated at more than US$165bn, and the fact that it represented the government lending to itself, the comparison is not exactly valid.

Even if one accepts the premise, the claim of a 30bp advantage to Mexico is not fair, since the 12.5bp fee reduces that to 17.5bp. The point also is made that rates would not have been 7.75% if the Treasury had come to market with US$35bn of stripped 30-year bonds.

The Journal maintains that the US$350m hidden aid was to fill a "gap" between new money commitments to the US$48bn financing plan and the amount that Mexico needed to put up as its share of the enhancement funding. This "gap" was supposed to be US$650m, which the Treasury's hidden gratuity brought down to the announced $300m.

But some respected bankers say that Mexico's purchase of the zeros was never included in the gap figure. The gap was indeed in the neighborhood of US$650m early in the year before enough banks changed their commitments, most from par bonds to discount bonds, but a few to new money, to bring the total down to US$300m. Initially, Mexico had estimated it would need 20% of the new package in loans. But the surprising number of banks that chose to trade their debt at a 35% discount reduced total debt enough to lower the percentage needed to collateralise it.

"We thought the gap would be so enormous that it would create a problem," one bank technical expert who worked on the deal said. "But it turned out to be a non-event, both in the amount and the lack of difficulty in filling it." That was accomplished by a net present value calculation on the collateral that took care of US$200m. The remaining amount Mexico is to put up itself.

The Journal appears to have rested its case on what is basically a difference of opinion. But it might also have been pulled into a long-standing, and unseemly, feud between the domestic and international areas of the Treasury that is well known and talked about in the markets. Participants on all sides say the original stories on the Mexican "bail-out" were leaked from the domestic area of the Treasury.

Under Secretary of the Treasury *David Mulford*, architect of the Brady Plan that is at stake in the Mexico deal, appears to be the focus of the Journal's attacks. Indeed a long editorial was headlined "Ollie Mulford" after the Oliver North of Nicaraguan Contra notoriety. Mulford wouldn't make many popularity lists among bankers and foreign finance officials, but sources pointed out that a programme as important as the Mexico plan is not the proper forum for personal attack.

Entel privatisation takes shape

Entel, Argentina's telephone company, will be privatised in a debt-equity swap in which the government will exchange the debt at face value plus accrued interest. A minimum cash payment, as yet undisclosed, will be part of the package, *Maria Julia Alsogaray*, head of Entel, told bankers last week.

Argentina will publish a list of debt that is eligible for exchange in the plan but it will

#33 1-29-90

Letters to the Editor

Mexico—No Concessions, Period

The Wall Street Journal has been running a series of articles regarding Mexico's debt package, which culminated with an editorial on Jan. 23. I would like to make the following clarifications:

There is absolutely no substance in your repeated statements that the U.S. Treasury granted Mexico a hidden subsidy of $350 million in order to salvage the Mexican debt deal through an artificially high yield on the bonds it was selling to Mexico to put the deal together.

First of all, there was no need to salvage anything. The Mexican deal was alive and well and about to close. The U.S. Treasury decision on the pricing of its bonds was an important piece of information in order to know the cost of the zero-coupon bonds to be purchased, but was not meant to be a source of relief, nor was it.

Second, you've got your numbers wrong. The interest rate of 8.05% per annum that you mention in the editorial as the yield on the zero-coupon bonds that Mexico would buy from the Treasury to collateralize the principal of the new bonds it will issue in exchange for the old debt is inaccurate. The rate is 7.925% and it represents the average yield for the three market days before the rate was fixed on the 30-year U.S. Treasury bond adjusted by one-eighth of 1%, which was charged by the Treasury as a "service fee."

I would also like to add that Mexico could never have accepted a rate other than the one negotiated at that moment, given that other countries, other corporations and other individuals have access, through the Treasury auctions or in the market, to the full bond rate. Why would Mexico accept a worse treatment when we are investing about $3 billion of Mexico's resources? We reluctantly accepted to pay the service fee because we recognize the advantage of the tailor-made issue, which is instrumental to the structure of the operation, but does not imply any subsidy.

The pricing decision was neutral from the point of view of Mexico's financial requirements to complete the amount of "enhancements" necessary for the deal. We were facing a shortage of about $300 million before the decision, and were still doing so after we knew of it. The shortage was resolved solely by those who had to deal with it: Mexico and the banks, through adjustments in the mechanics of the collateral account, a matter totally unrelated to the pricing of the zeros.

You must also be informed that the pricing technique used by the U.S. Treasury is similar, and in some cases identical, to others that we have negotiated with other countries from which we are also buying zero-coupon bonds in their own currencies, as part of this package.

Regardless of your sympathy for Mexico, the U.S. Treasury, the Brady Plan or particular U.S. officials, I can only reiterate that, regarding the zero-coupon bond pricing decision, Mexico did not ask for any concessions; Mexico did not expect any concessions; Mexico got no concessions; Mexico made no concessions.

ANGEL GURRIA
Undersecretary for International
Financial Affairs
Ministry of Finance and Public Credit
Mexico
Mexico City

(The difference between the yield of 8.05% cited in the editorial and the 7.925% cited by Undersecretary Gurria is the 0.125% service fee paid to the U.S. Treasury. While 7.925% of course represents the net cost of the zero-coupon bonds to Mexico, the service fee would ordinarily be paid regardless of the index chosen for the price of the sale. For the purpose of comparing different indexes, the 8.05% market rate for conventional Treasury 30-year bonds is the appropriate figure for comparison with the market rate of 7.75% for zero-coupon Treasuries.—Ed.)

* * *

Your editorial is mischievously misleading when you attack the Treasury as if it were clandestinely subsidizing Mexico by selling it zero-coupon bonds (at implicit interest rates consistent with market coupons), presumably in violation of the constitutional requirement for congressional appropriations. Since when have interest payments made by the Treasury on the securities it issues been a subsidy? And what claim of unconstitutionality or subsidy can you bring against the issuance over a half-century of those series of savings bonds that embody interest in their accumulation from original purchase price to their final redemption?

ROBERT V. ROOSA
Former Undersecretary
of the Treasury
for Monetary Affairs

THE NEW YORK TIMES, TUESDAY, JANUARY 16, 1990

Mexico and Banks Said To Close Financing Gap

By JONATHAN FUERBRINGER

Mexico and its bankers have agreed on how to cover the $300 million shortfall in their landmark deal under which most of the banks involved will reduce the value of the country's existing debt by 35 percent, according to bank and Mexican officials.

At the same time, the Bank Advisory Committee, led by Citibank of New York, is hoping to get Canadian banks to sign off this week on a $1.2 billion bridge loan that is the other last detail of the deal to be worked out. One reluctant British bank, Lloyds Bank, agreed to the bridge loan providing interim financing last week. The brige loan, by providing financing to the Mexicans earlier in the year, allows some of the guarantees involved in the proposal to be offered earlier.

Both actions reflect the difficulty of tying up all the loose ends in this deal, which will be the first completed under the Bush Administration's debt strategy known as the Brady plan, named for Treasury Secretatry Nicholas F. Brady. If the deal is finally completed early next month in Mexico, as now planned, the conclusion will come 11 months after Mr. Brady first disclosed the new debt strategy and 10 months after Mexico and its bankers began negotiations.

Initial Outline in July

The initial outline of the deal was announced in July and involved the reduction of debt. The Mexicans are inviting the advisory committee members and the chairmen of the banks involved to Mexico for the signing ceremony, officials said.

The $300 million gap in the financing is a shortfall in the money necessary to provide the guarantees or what bankers call enhancements for the debt plan covering $48 billion of medium- and long-term Mexican debt.

The details of the method of covering the $300 million financing gap have become an issue because of a dispute in the United States Treasury and suggestions from Treasury officials and others that American taxpayers might be tapped to cover the gap. Officials from Mexico and the banks involved in the negotiations and the Treasury said, however, that this was not the case.

Under the overall debt plan, the bankers could chose debt reduction, either by lowering the principal on existing loans or accepting lower interest payments at a fixed 6.25 percent. Both reductions equal about a 35 percent reduction in the value of the existing loans. A third option allowed banks to choose to make new loans equal to 25 percent of their current exposure.

The Mexicans are to provide guarantees for both the principal and interest to be paid. They will buy zero-coupon Treasury bonds to guarantee the principal of the new bonds that are swapped for the old loans and will set up a revolving fund to cover the interest payments for up to 18 months. If all the interest payments are made by Mexico, the fund is rolled over for another 18 months.

The Mexican Government has $7 billion for these guarantees, which turned out to be $300 million short because more banks than expected chose to do principal reduction and fewer banks than expected chose to make new loans. The $7 billion includes money from Mexico, the International Monetary Fund, the World Bank and the Japanese Government.

Under the proposal the banks and Mexico have worked out to cover this gap, the Mexican Government will come up with as much as $100 million from its reserves. In addition, the money put in the fund to cover the interest payments will be cut by up to $200 million. The interest earned while the money is in the fund will make up the $200 million gap.

The question of a subsidy from the taxpayers arose when the Treasury separately decided what interest rate and price to offer on the zero-coupon bonds used to back the principal payments on the bonds that are traded for the old loans. Some Treasury officials suggested that a below-market price for these represented a subsidy from taxpayers to cover the $300 million financing gap. A zero-coupon bond is sold at a large discount to its face value because it pays no interest until its maturity. The higher the yield, the less that has to be paid for the face value of the bond.

> The deal would be the first completed under the Brady plan debt strategy.

The interest rate is 8.05 percent and there is a Treasury fee of 0.125 percent, which lowers the rate to 7.925 percent. This is about one-quarter of a percentage point above what the yield is on 30-year zero-coupon bonds in the market. Some in Treasury had argued that the Mexicans should get this lower rate, which would mean they would have to pay more for their zero-coupon bonds, thereby aggravating the lingering financing problems with the debt package.

Louis Crandall, the chief economist at R. H. Wrightson & Associates in New York, said there is an "institutional distortion" in the zero-coupon bond market at 30 years that created the lower yield. In addition, he said, this market is very small, amounting to a total face value of $45 million and a value today of around $5 million.

"This seems to have been a reasonable choice," he said. "There is no point in putting a gun to the Mexicans' head and forcing them to accept the lower rates because of this oddity in the market." He said that moving back just a few years in the term of the zero-coupon bond brings the rate in line with that on regular 30-year Treasury bonds, the rate that the Treasury chose to use.

12:51 EST 01/09

MEXICO PROTESTS CHARGES TREASURY IS SUBSIDIZING DEBT SWAP DEAL

By Steven K. Beckner

- WASHINGTON (MktNews) - Reports that the Treasury Department plans to sell Mexico zero coupon bonds at preferential rates to back its pending debt swaps are "pure unadulterated crap," a senior Mexican financial official complained Tuesday.

Meanwhile, the Treasury defended itself against charges that its pricing plans for the zeroes will cost taxpayers money. A Treasury spokesman said there is no "discount" involved other than the usual discount involved in selling a coupon-less security at a fraction of its maturity value and said Treasury is merely pricing the bonds in the same fashion it priced bonds sold to Mexico in 1988 as part of another debt swap deal arranged in late 1987 by J. P. Morgan & Co..

The price of the zero coupon bonds "will be determined by the average of the prevailing market rates on 30-year Treasury securities for three days ending Jan. 5, 1990, less a fee of one eighth of one percent," the spokesman said. "That works out to 7.925%."

The pricing plan is "based on sound market principles," the Treasury spokesman continued, adding, "We used the benchmark of the 1987 deal, which was pricing on bonds not strips."

Mexico reacted with outrage to charges from some in Congress that the Treasury is subsidizing the Mexican debt reduction scheme and costing taxpayers money through its pricing of the zeroes. A Mexican official familiar with the details of the debt plan said, "At no point whatsoever was there a question of a subsidy or a discounted price.

"If anything, Treasury wanted to overcharge us," the official continued. "They wanted to charge us a price above the market price, and we would have had to go elsewhere." The implication was that Mexico might have had to buy stripped U.S. government securities in the open market or might even have sought to buy zero coupon bonds from another government denominated in another currency.

The Mexican official said Mexico would be buying roughly $500 million more of zero coupon bonds than originally projected but said allegations that this amount will be transferred from the U.S. taxpayers is "nonsense."

Under the original scheme, Mexico was to use $7 billion from the International Monetary Fund, the World Bank, Japan and its own reserves to buy the zero coupon bonds, which at maturity would pay the principal on Mexican government bonds to be issued to banks in exchange for foreign bank loans totalling $48 billion. That amount will now be increased to $7.5 billion, he said.

CONT.

Mexico, cont.

Some banks have agreed to accept Mexican bonds equal to 65% of the value of their outstanding loans, while other banks will exchange loans for bonds at par but with a greatly reduced interest rate. Still other banks have promised new loans.

Private observers didn't know quite what to make of the controversy over the zero coupon bonds. James Orr, executive director of the Bretton Woods Committee, said he had no quarrel with Treasury's pricing scheme, observing it is "analogous to the Morgan-Mexico deal."

Tom O'Neill, chief zero coupon bond trader for Dean Witter Reynolds, said it's conceivable the Treasury pricing plan could have a small budget impact. However, he observed that, given the recent uptrend in yields on long-term government securities, a zero coupon bond yielding 7.925% "if anything would be a money maker for the Treasury." The current yield on conventional 30-year Treasury securities is 8.08%.

Treasury will be announcing its quarterly refunding, which will include 30-year bonds, at the end of this month. "I assume they'd be able to borrow that money at less than 8% unless the market changes," said O'Neill.

Meanwhile, Mexico continues to wait for a number of smaller banks to conclude their negotiations on their participation in the debt reduction package before the entire package can be implemented. "I think we should be ready to iron out the last details in the next couple of weeks at most," said a Mexican official close to the negotiations.

Upon completion, Mexico hopes to see an inflow of capital and a reduction in domestic interest rates that will aid the long-suffering country's economic recovery.

Pricing of Treasury Zero-coupon Bonds for Mexico

- The United States Department of the Treasury sold Mexico non-marketable 30-year zero-coupon Treasury bonds to be used as collateral for the debt and debt service reduction bonds resulting from the Mexican financing package.

- At the time of the pricing Treasury had only issued non-marketable zero coupon bonds on two other occasions -- the Morgan/Mexican debt reduction deal in 1987-88 and the initial issue of zeros to REFCORP in October, 1989.

- Furthermore, Treasury has not itself issued zero coupon bonds directly in the public market.

- The Treasury STRIPS market, a derivative market resulting from the stripping of Treasury coupon instruments by market participants, remains smaller than the coupon market and somewhat volatile.

- The Treasury pricing decision for the zero-coupon bond for Mexico was based on principles reflecting both the size of the Mexican transaction and the precedent of the 1987-88 Mexican purchase of zeros.

    - The earlier Mexican deal was priced off the coupon rate because the STRIPS market was deemed to lack sufficient depth and the size of the transaction was large relative to the then outstanding STRIPS market.

    - The current transaction size of approximately $30 billion face amount is even larger relative to the STRIPS market today.

    - The existing STRIPS yields would be severely affected if a transaction the size of the $30 billion face amount of Treasuries for Mexico were issued in the public market. It is likely that the STRIPS yields would be driven toward the coupon yields.

- The specific pricing formula for the Mexican transaction involved the average 30-year U.S. Treasury coupon borrowing rate for the 3-day period ending January 5, 1990 of 8.05%.

    - A fee was charged by Treasury in the form of an adjustment of the annual yield by 1/8%, which is identical to the fees charged for Treasury special issues over many years.

    - The Treasury's final borrowing rate from Mexico was 7.925%.

Mr. LEWIS. Mr. Chairman.
Mr. OBEY. Sure.

COMMERCIAL BANK PARTICIPATION IN DEBT RELIEF

Mr. LEWIS. Mr. Chairman, if I might, I know you are going to close the hearing in a moment, but I would like to just add my voice to the record in at least partial, but I think large, support of your view that putting pressure on our banks who are involved in sizable debt relations with developing countries is an important part of the process we ought to be about here in this committee.

I say that in no small part because it is my personal view that American banks particularly, other banks as well but American banks particularly, at one time in recent history looked at developing countries kind of as a candy store where they could take their sizable deposits, part of which flowed when the oil crisis came along, and give them at bigger spreads somewhere else and conditions to those countries that they would not give to you and I in the private sector in the United States.

Having said that, there is little question that that gives us all a problem, and the reason we are participating in helping restructuring those countries is because we are concerned about the countries. We are also concerned about our own financial institutions and their viability.

Also, we should be interested because they got there in part because the American government had encouraged those governments by way of soft loan windows and otherwise to become involved in debt that was way beyond their means and we encouraged the banks to follow.

STATUS OF LATIN AMERICAN DEBT RESTRUCTURING

By way of a specific question, Mr. Chairman, would you for the record tell us what other Latin American countries are major candidates for debt restructuring, and as you give us that information could you give us some idea of where you are in terms of those discussions, what kind of time frame are we looking towards?

Secretary BRADY. Well, with regard to the three largest countries, Venezuela I would say, Congressman Lewis, is close. I would be very disappointed if we did not have a conclusion to the Venezuelan debt negotiations in the very near future. By that I mean I would be very disappointed if it was not done within the next months. I am hopeful it can be done in the next month, and possibly within a much shorter time span than that.

With regard to Brazil, which has a large debt problem to conquer, President Cholor has been here, and we have met with him. I think he may have come up to the Hill here and met with some of the members of Congress. All of the actions that he is talking about taking look to us like the foundation stones for reforming the Brazilian economy and the first steps toward a settlement, an arrangement, a restructuring of the Brazilian debt. So I am very hopeful about Brazil.

I am nearing confidence on Venezuela. I am hopeful about Brazil. The situation in Argentina, as the President of Argentina has said, is very severe. President Menem is trying his hardest to deal with it. So far I do not see the foundation stones that I referred to in Brazil in terms of an economic program which would lead us to a restructuring there in the near future.

I am impressed with the man's determination and forthrightness, and he has said recently that he is going to come again and try to sweat this problem out. So let us give him credit. He is trying, and we will deal with it as we see progress being made. But of course, you have to have the prerequisite of IMF programs and the support that that brings.

I should not in mentioning these three large countries neglect what has been going on in Chile and what is starting to take place in Uruguay. We have met with the presidents of both of those countries and we think progress is under way.

So I think, with respect to Latin America——

Mr. LEWIS. Any progress in Bolivia?

Secretary BRADY. Do you want to speak about that, Charles?

Mr. DALLARA. Just to say that significant progress has been made. They are in the process of yet another buyback operation, which should bring their debt down to below 20 percent of what it was.

Mr. OBEY. Mr. Secretary, we have to get out of here in five minutes so that this committee room can be prepared for the next hearing.

Mr. LEWIS. Mr. Chairman, if I could just add, just for a second for your edification. Relative to Argentina, some of our colleagues—I was a part of a visit to Argentina, among other places, and I was really interested to see that their major source of tax revenue comes from a value-added tax. Just a piece of the sense they need to make out of their economy: People writing sizable checks for goods in Argentina, strange, they made the checks out to individuals, not to the company where they were buying the product.

I mean, I would not want to assume that money might be going out of the country, but interesting, craziness.

WORLD BANK LENDING TO CHINA

Mr. OBEY. Mr. Secretary, just two quick questions. With respect to World Bank lending to China, I would like to simply buttress what Mr. Lewis said. I think the World Bank proceeding at this point to renew business as usual lending would be an act of extremely unfortunate judgment. I have talked to Mr. Conable about this directly. I have told him I think it is inadvisable to go beyond where the bank has gone at this point.

Let me be very blunt about it. If the Administration is interested in having an IDA appropriation in this Congress, they are going to be asking us to perform an impossible act if the World Bank is in the process of resuming normal funding to China until we have seen some adjustment.

I would like to see an attitude adjustment hour before any further steps are taken. With all due respect to the President's judgment in China, I think I know something about China, too, and I think that we are in danger of going down the wrong road and sending the wrong message to the wrong people. Those people are not going to be around in that government very much longer.

COLLECTIBILITY OF POLISH DEBT

Let me simply say, with respect to the Polish debt situation and the Eastern European Bank, do you really believe that a significant portion of the Polish debt which is now owed is collectible? Can you cite me anybody else who does believe that it is?

Secretary **BRADY**. That it is collectible?

Mr. **OBEY**. Yes.

Secretary **BRADY**. A sizable portion collectible? I think that as of today, no. Hopefully, the changes that might be made will lead to a future for Poland where these debts can, if properly handled, be addressed in the future. And I think that the precedent which flows from answering that question directly is not one that I can contemplate right at this particular point in time in terms of other countries.

Mr. **OBEY**. Well, I am not interested in other countries. We have a special situation. Every time we raise this, I know we get concerns expressed in Treasury about, well, what does that mean for Brazil or Argentina? Let us just put the western hemisphere off limits for the moment and recognize we have had an historic change in Eastern Europe.

That is the region where two world wars started. It seems to me that if we do not take action sufficient to the need, we risk continued chaos in that part of the world. That is often the normal course of events there.

My point is simply this. Dr. Sachs when he testified, indicated his belief we ought to use our leadership capacity to see that Poland receives at least the same consideration for debt reduction that the country that caused World War II received at the hands of the United States. We in the fifties provided for significant debt reduction for the Germans simply because we recognized it was necessary to jump-start that economy.

My own view is that we will have great difficulty persuading potential investors that they ought to take a fling in Poland with that kind of debt overhang. That leads me to my concern about the Paris Club.

The State Department has told this committee that from January 1980 to April 1989, 117 Paris Club agreements have been negotiated for 45 different countries. That averages 2.6 Paris Clubs per country in this decade. Some countries have gone to the Paris Club five and six times.

This is what I mean when I talk about a shell game. There is no question that rescheduling has often been useful. However, when it becomes a substitute for an admission that we have a very serious problem on our hands, and it masks our ability to face the uncollectible nature of some of these debts, then I think you get into one of the problems that Mr. Edwards and I have with continuing to support appropriations for the international financial institutions.

I think that keeping a major share of Polish debt on the books is about as realistic as having the Export-Import Bank say they still expect to have Cuba repay its bad loans. I just do not think that is in the cards.

I think the system is hiding from taxpayers worldwide the fact that we really have a very serious uncollectibility problem on our hands. I think if we do not begin to make some intelligent and discreet differentiations between countries that do require an admission of truth on our part and countries whose conduct does not warrant such action, we are going to be inviting a gradual loss of credibility for the entire system.

That makes it very difficult for people like me to continue to support funding for the banks, as much as I think it makes sense intellectually. I think the practice does not measure up to the purpose, and that is why I come down so hard. I insist that, if we do not take advantage of the opportunity and recognize the obligation that is now before us with respect to Poland, then we really are inviting problems we do not need.

I frankly think part of the price of German reunification ought to be a recognition on their part of the Polish debt situation. Since so many of the Polish loans are owed to German creditors, part of the price of an orderly transition to a new order in that part of the world ought to be a recognition of credit reality on the part of the Germans and everybody else with respect to Polish debt.

I mean that just as firmly as I can possibly express it.

Secretary BRADY. I understand, Mr. Chairman. I would only add to what you have said that the Treasury organized a $500 million bridge loan, to which the United States contributed $200 million and a billion dollar currency stabilization fund for Poland.

Incidentally, I think it is interesting that under the stabilization fund the Polish government has not drawn any funds down at this point in time. With regard to the bridge loan, I believe they did draw down $200 million, but they paid it back.

Mr. OBEY. I understand that. There is no country that is more crucial to the success of freedom right now than Poland. If the Polish model succeeds it sends all of the right messages to the Soviet Union and every other country misguided enough to think there is still a future in anything but market-oriented economies.

Secretary BRADY. You have said it better than I could.

Mr. OBEY. I just hope to God that we recognize that.

I have some other questions for the record. I appreciate your time here.

REQUEST FOR CALLABLE CAPITAL FOR MDBS

Secretary BRADY. Thank you. Mr. Chairman. I know that there have been no minds changed this morning. At least from what has been said, it does not seem that there are too many.

But I would reiterate our request for the $1.6 billion in callable capital in the fiscal year 1990 supplemental request, and the $1.7 billion in BA requests for the MDBs in the fiscal year 1991 request. I know what the circumstances are, but if you could give us the benefit of the doubt we will do our very best.

Mr. OBEY. Why do we not try to talk about that more before we make up our mind on it.

Secretary **Brady**. Okay. Thank you.

Mr. **Obey**. Thank you.

[Questions and answers for the record follow:]

Questions for the Record Submitted by Chairman Obey

EASTERN EUROPEAN DEVELOPMENT BANK

Question. Mr. Secretary. Dr. Jeffery Sachs suggested to this subcommittee in an earlier hearing this year that we really should not consider funding an Eastern European Bank until the United States successfully got the Germans to lead an international effort to renegotiate international debt with deep debt reduction.

Dr. Sachs made his comments particularly in the context of Poland, because their debt overhang, even with their extremely generous 14 years Paris Club Agreement, was in his view so burdensome that it would cause naturally cautious businessmen to choose to invest elsewhere.

He also stated that German leadership was only appropriate because the German Government and the German Banks hold the largest amount of Polish debt—and because the Germans were the recipients of similar debt reduction benefits through American efforts after WWII in the 1953 London Agreement.

Do you agree that the Poles cannot possible pay their current debts and that a debt reduction agreement is necessary and fair in the context of their agressive reform program?

Answer. Because of Poland's heavy debt burden it has been U.S. policy to support extremely generous rescheduling for Poland in the Paris Club, new official flows in the form of grants or highly concessional loans, and a reduction of Polish debt to the commercial banks. These measures combined with successfull economic reforms will fundamentally improve Poland's financial prospects. Official debt reduction raises difficult and complex procedural and budgetary questions.

Question. Mr. Secretary, we have seen a lot of debate on assistance for the Soviet Union in the past few weeks. The majority leader of the House suggested that the U.S. should be looking at helping the Russians particularly in areas that could also help American business and agriculture exports.

A few members of the extreme right wing of the Republican party chose to misrepresent his statements and strongly attacked any idea of providing any type of assistance to the Russians.

Frankly, this attack surprised me because it seemed to me that the administration was directly faced with this question in considering membership in the European Bank—because the European community insists on Soviet membership in the Bank and they seem to strongly favor allowing the Soviets to directly borrow from the Bank.

Is that a fair characterization of the situation, and is it not fair to expect that the Administration in the end will agree to Soviet membership and to some degree of Soviet borrowing from the new bank?

Answer. You are accurate in saying that the USSR will be a member of EBRD. It has also been determined that Soviet borrowing will be limited to the amount of their paid-in capital.

Question. Mr. Secretary, I would like to further clarify your intentions for funding this new institution.

The Administration has requested $300 million for a special initiative for Eastern Europe in the 1991 Budget, but has not specifically requested any funding for the Eastern European Bank.

We have been told that if the Administration decides to join the Bank, and that seems to be fairly inevitable, then you will not be requesting any additional amounts. Rather, you will be asking that we use some of the already requested $300 million for that purpose. Is that true?

Answer. Yes. It was our intention that any FY 1991 funding required for U.S. participation in the EBRD come out of that $300 million.

REINITIATION OF WORLD BANK LENDING TO CHINA

Question. Mr. Secretary, the Head of the World Bank told a group of Congressional staff that the Bank intended to lend about $1 billion in new loans to China by the end of their fiscal year——meaning by July 1st this year.

While we have seen the Bank already make an earthquake loan to China this spring and an agricultural loan to a poor rural area, both of which totalled about $100 million, and were justified as "basic human needs" loans—we frankly are not prepared to be supportive of what amounts to the reinitiation of the full Bank lending program to China given the Chinese human rights violations last year and their ongoing crack down on intellectuals and students and the private sector.

What are your thoughts on the reinitiation of the full Bank lending program to China?

Answer. The United States and our G-7 allies achieved a major success in preventing any new World Bank lending to China from last June until early February this year. We continue to oppose strongly a general resumption of multilateral development bank (MDB) lending to China. We remain most concerned about China's current human rights situation and its economic policies.

The United States has not, however, opposed a gradual resumption of lending which is limited to projects which clearly meet basic human needs (BHN). Supporting BHN projects in human rights problem countries is an expression of our humanitarian concern for the welfare of the poorest and most vulnerable people in those nations. This approach is consistent with existing human rights legislation and past United States Government practices in other human rights countries.

The United States and all our G-7 allies supported a $30 million IDA credit for North China Earthquake Reconstruction on February 8, a $60 million IDA credit for Jiangxi Agriculture on February 27, and a $50 million IDA credit for Vocational and Technical Education (VTE) on March 27. All these projects were clearly for BHN.

The Administration fully shares your concerns regarding World Bank President Conable's remark to Congressional staff that the Bank intends to lend about one billion dollars to China prior to the conclusion of the current World Bank fiscal year on June 30, 1990. The Administration has made it clear to top Bank officials that such a lending level would be totally unacceptable to the United States.

Question. How do you suggest that the United States Congress send the message to Mr. Conable that a "business as usual" approach to Chinese lending is simply not acceptable until we see changes in the Chinese political situation?

Answer. The Administration at the highest levels has already made it clear to Mr. Conable that a "business as usual" approach to lending for China is clearly unacceptable to the United States. Additionally, both Mr. Conable and the Chinese Government are well aware of the "Sense of Congress" resolution on China lending passed late last year.

Additional Congressional action in this area is unnecessary, and could even be counter-productive. This is primarily because it could reduce our tactical flexibility with our allies, and therefore our overall effectiveness on the issue of China lending.

Panamanian and Nicaraguan Arrearages to the International Financial Institutions

Question. Mr. Secretary, we have before us two supplemental budget requests totalling $500 million for Panama and $300 million for Nicaragua.

Both these aid requests include money to pay arrearages to the international financial institutions.

In the case of Panama, they owe about $560 million. In the case of Nicaragua, they owe about $234 million. The share of the U.S. assistance going toward paying these bills is $130 million for Panama, and $50 million for Nicaragua.

The reason I raise this question is that in the past we have seen relatively small amounts of economic support fund monies going to pay countries debts to these institutions. But, we have never seen large direct requests by an administration aimed at paying a portion of other countries debts.

Is this a pattern that you believe we will see growing in the future?

Answer. If countries are to achieve market-oriented growth, consistent with our political and economic values, they will need to work with the international financial institutions (IFIs) in implementing comprehensive macroeconomic and structural reforms. Thus, it is important that we be prepared, if necessary, to work with the IFIs and these countries to encourage appropriate economic management. Countries with arrears to the IFIs are generally unable to receive their support.

Decisions on whether and how best to help arrears countries repay their overdue obligations to the IFIs will necessarily be made on a case-by-case basis. U.S. consideration will depend on a number of concerns, including overall assistance levels, policy priorities, and the pace of reform in a given arrears country. By helping a country clear its arrears, the United States reduces potential future requests for bilateral assistance and contributes to a strengthening of the financial position of the

IFIs. Given the IFIs' central role in addressing economic reforms, U.S. interests are well-served by working with these institutions.

Question. Why do you believe that it is good policy for the U.S. to pay other countries debts rather than to give assistance for for more immediate needs?

Answer. We want our assistance to be an investment that will have long term benefits for the recipient country. By helping a country to clear its stock of arrears, we help open up lines of credit for that country that would otherwise be unavailable. In this way, U.S. assistance is leveraged: our contribution can help unlock substantial IFI financing. This will take some of the burden off the U.S. in being the only source of external finance and technical expertise. Also, helping a country regain access to financing which is linked to economic reform measures, as occurs under IFI arrangements, increases the potential effectiveness of future U.S. assistance, since our aid would be utilized in a more efficient, market-oriented environment.

Question. Doesn't this trend of countries needing increased foreign assistance to pay international debts suggest that we are seeing a growing crisis caused by the failure of the IMF and the World Bank to successfully trade real economic reforms for lending aimed at increasing countries abilities to service their international debts?

Answer. No. Countries that are in need of increased foreign assistance to help service their international obligations are by and large countries that for political reasons rejected economic reforms recommended by the IMF and World Bank and willingly accumulated arrears. New governments are taking over in these countries and are inheriting debt burdens that are beyond their capacity to pay with their own resources. We are requesting funds to help governments which want to set out on a new course and to reverse the failed policies of their predecessors.

Question. Would you tell me how many countries are now in arrears to the IMF, and for how much?

Answer. Eleven countries have overdue obligations of six months or longer to the IMF. At end-1989, their arrears totaled $4.1 billion.

THE WORLD BANK "GREEN FUND"

Question. I understand that the World Bank has initiated discussions with potential donors—including the US—on a proposal to develop a special fund to address global environmental problems.

As I understand it, the bank has proposed that donors establish a new concessional lending facility at the Bank, similar to IDA, which would fund projects concerning global warming, stratospheric ozone depletion, biodiversity and other issues of global importance.

As you know, increased funding for environmentally beneficial projects has been a central element of this Committee's calls for environmental reform at the World Bank.

I agree that additional aid resources will be crucial in helping developing countries address global problems—solutions to which may not guarantee them immediate economic or local environmental benefits.

What concerns me, however, is that the Bank's track record on environmental issues does not give me confidence that it would necessarily be an adequate trustee for such a fund.

Preliminary discussions among donors are currently taking place in Paris, correct?

Answer. Yes. Preliminary discussions among potential donors are taking place this week at a meeting in Paris.

Question. What is the initial Treasury position on this proposal?

Answer. We believe that the World Bank could play a very useful role in this area. We have concerns, however, about the exact nature and scope of a new facility, the budget implications of a U.S. contribution to such a facility, the management of such of facility, and how it would relate to the Bank's existing environmental programs.

Question. While I support the Bank's goal of devoting more resources to environmental problems, I'd like you to convince me that Treasury is taking adequate steps to ensure that the Bank demonstrates its ability to manage such additional funds through substantial improvements in its existing programs and policies.

Answer. As I have said, we believe that the World Bank could play a very useful role in this area. It has long standing experience in the identification and appraisal of development projects that could be applied to global environmental issues. The Bank been criticized for being too slow to accept environmental reforms. We agree with the criticism and have pressed the Bank to make more progress is this area. Significant progress is being made in adoption of the Environmental Impact Assessment (EIA) operational directive and in new commitments to do more in protection of tropical forests and measures to promote greater reliance on energy efficiency and conservation measures. Projects raising environmental concerns also continue to reach the Board and we will continue our efforts to monitor the Bank in this area.

Question. How will your staff actively seek demonstrable evidence of Bank progress in the areas of forestry, energy efficiency, environmental impact assessments and public access to information?

Answer. We have been working very closely with Bank management and staff and with non-governmental organizations in all of these areas. Forestry is getting a particularly close review. We have been working very closely with the World Wildlife Fund in an effort to get more emphasis placed on preservation and protection measures. A review of the Energy Sector Management Assistance Program is going forward and we are looking for specific steps that will be taken to integrate its work into the lending operations of the Bank. On environmental impact assessment, the policy has been adopted and several EIAs are already under preparation. It is a large task, however, to get the overall system into place and we will be monitoring the Bank's work in this area very closely over the next year.

Question. As such, will Treasury representatives at this week's donor meeting recommend "going back to the drawing board" if this Committee's and other's concerns are not met?

Answer. Treasury's representatives at this week's meeting will ask for further elaboration of the proposal and for more information on how such a facility would be structured and managed and how it would affect the on-going programs that I have already mentioned. In some sense, this could be said to mean "going back to the drawing board."

Question. Again, convince me that this Committee's concerns will be met in any proposal Treasury supports regardng this lending facility.

Answer. We understand your concerns and we share them. As you know, these concerns have been at the core of Treasury's environmental initiatives in the IDA-9 negotiations, at meeting of the Development Committee and at the annual meetings of the Bank and the IMF. As I have indicated, there is the issue of budgetary support for the proposal. Also we could not go forward with support for the facility until we believed your concerns and our concerns were being met.

Question. Finally, will Treasury demand that the Bank actively solicit public participation in discussions of the fund?

Answer. Yes. Treasury representatives will be emphasizing the need for consultations with non-governmental organizations and members of the scientific and university communities as well as with bilateral donors and environmental agencies.

TROPICAL FORESTRY ACTION PLAN

Question. The Tropical Forestry Action Plan (TFAP) was initiated in 1985 to redirect the programs of the World Bank and other donors toward slowing down the rate of tropical deforestation. At that time, many of us were hopeful that a coordinated donor effort would be highly effective in helping developing countries conserve tropical forests.

Unfortunately, it seems our hopes have been dashed. As I understand it, the TFAP process has been widely criticized for promoting industrial timber extraction at the expense of natural forest conservation and preservation of biodiversity. Furthermore, TFAP has consistently excluded the public and nongovernmental organizations in developing countries from the decision-making process. In general, the process has been highly secretive and little if any of TFAP planning and implementation has been available to the public.

Last year, Barbar Conable concluded that TFAP was an ideal solution to global environmental problems and committed the Bank to a three-fold increase in forestry lending. However laudable it appears for the Bank to increase its lending for forestry projects, it is essential that reforms be undertaken in the TFAP process to assure that conservation and sustainable use of tropical forests will be given proper emphasis by the Bank.

What reforms is Treasury seeking in the forestry sector, to ensure that the Banks are not lending solely for extraction projects?

Answer. Treasury has encouraged a broad-based approach to forestry projects and has pressed for adjustments to specific projects. The broad-based approach includes reform of policies in the forest and related sectors, strengthening of forest management institutions, consultation and cooperation with forest dewellers and local communities, and protection of forests for watersheds and biodiversity. Reforms of logging policies are especially important if sustainable use of forest is to become reality. At the same time, provision must be made for the fuelwood requirements of rural people and the broader needs of traditional forest dwellers.

By and large the MDBs have not sought to finance pure logging projects. World Bank forestry projects, in particular, have entailed policy dialogue leading in the forestry sector that have potentially far-reaching effects. These projects also include significant institutional stengthening components. However, implementation failure remains a very real concern and Treasury has pressed the Bank to increase its project supervision and to create independent monitoring entities in the field.

Question. What reforms to date has Treasury gotten the Bank to agree to in the TFAP process? What actual reforms has the Bank implemented with regard to TFAP?

Answer. Treasury has focused on several forestry issues in its dialogue with the Bank. These include (1) policy reforms; (2) adequate institutional strengthening prior to implementation of other components such as managed logging; (3) treatment of issues outside of the forestry sector that affect forests (e.g., agricultural encroachment); and (4) close monitoring, preferably involving local NGOs and community groups.

The World Bank recently brought a forestry project for the Ivory Coast to the board for consideration. Treasury and AID, working with the World Wildlife Fund, came up with a proposal for more explicit phasing of project components that would better address the concerns enumerated above. A majority of exeutive directors supported this proposal. The Bank agreed to go back to the Ivorians to try to negotiate changes. Treasury views this as a significant step in pushing the Bank towards an approach that emphasizes protective measures and improves chances for smooth implementation.

Question. Is UNEP currently doing an intensive review of the TFAP? What is expected to come of it? When is it expected to be completed?

Answer. UNEP is not doing a review of TFAP. The U.N. Food and Agricultural Organization (FAO), the parent agency of TFAP, has initiated a review, using a panel of development experts. Their report is expected in June 1990. The World Resources Institute, a research organization which was involved in the original elaboration of the FTAP process, is also conducted a review, particularly to look into NGO criticisms of FTAP. Lastly, a number of NGO critiques, the most comprehensive of which has just been issued by the World Rainforest Movement, have spurred discussion in the implementing agencies, both bilateral and multilateral.

Question. What assurances can you give me that the very communities which are supposed to be benefiting from this type of assistance are brought into the planning process?

Answer. Treasury has emphasized consultations with borrowing country NGOs and local communities in planning for all MDB projects. This principle was reiterated in the agreement for the most recent IDA replenishment. In the forestry sector, we have pressed the banks to consult with local communities, both forest dwellers and those in neighboring areas. The World Bank's project in the lowland forests of Bolivia is a good example of consultation and cooperation with indigenous communities and farmers' groups in the project area. At Treasury's behest, the African Development Bank undertook a study of the effects of its Congo forestry project on the pygmy population living in the project area. The key is to make such consultations, cooperation and studies a routine part of project preparation.

MULTILATERAL DEVELOPMENT BANKS AND DEBT FOR ENVIRONMENT INITIATIVES

Question. What measures have been taken to direct the U.S. Exeutive Directors of MDBs to facilitate debt-for-nature exchanges and other debt conservation initiatives as recommended in the International Development and Finance Act of 1989?

Answer. The U.S. Executive Directors for all four multilateral development banks have been instructed to press the banks to seek opportunities for debt for nature exchanges. Treasury has discussed with the World Bank the possibility of using a portion of environmental loans to support debt for nature swaps as recommended in the International Development and Finance Act of 1989. At U.S. behest, the report for the IDA IX replenishment urges the World Bank to act as a catalyst for debt for nature swaps. The MDBs, however, have reported little interest on the part of their borrowing countries.

A swap involving a large tract of tropical rainforest in Paraguay that is owned by the International Finance Corporation (IFC) is now under active discussion. The U.S. Executive Director has encouraged the World Bank, the IFC, the Nature Conservancy, the Bertoni Foundation (Paraguay) and USAID to work together to find a creative financing solution for turning the tract into a nature reserve.

Question. Are you aware of whether or not the professional environment staffing level of the MDBs is adequate to carry out these provisons? What is the current staff level devoted to environment and conservation issues in the various MDBs?

Answer. We believe the staffing levels in the World Bank and the Inter-American Development Bank are adequate although efficiency may be improved by redeployment. The Asian and African Development Banks do not yet have adequate staff; the U.S. has and will continue to press on this issue.

World Bank: 78 full time staff plus consultants.
Inter-American Bank: 17 full time staff consultants.
Asian Bank: 5 full time staff plus consultants.
African Bank: 3 full time staff plus consultants.

Question. The MDB environment departments have been criticized for not being effective within these large organizations. Does Treasury have a method of assessing whether the environment divisions are capable of effectively changing MDB policies or whether they play only a limited role in commenting on or developing debt relief and debt restructuring mechanisms?

Answer. The environmental division in the Inter-American Development Bank is new and its effectiveness remains to be seen. The World Bank regional environmental divisions are actively involved in analyzing projects as well as initiating environmental programs. The Asian Bank has good policies but requires a higher staffing level in order to cover Bank activities in a more comprehensive fashion. The African Bank is working on an environmental policy now. Its staff is inadequate and the U.S. has pressed for more staff and more rapid integration of environmental issues into Bank activities.

The MDBs do not play a direct role in developing debt relief and debt restructuring mechanisms. The World Bank does play a role in debtor countries' efforts to pursue debt reduction by helping design and implement economic reform programs and by providing financial support for specific debt and debt service reduction transactions. As environmental concerns are increasingly integrated throughout the operations of the World Bank, the environmental divisions will play more influential roles in incorporating environmental issues into the overall reform programs of debtor countries. We continue to press for further progress in this regard.

Question. Has Treasury instituted any new incentives for commercial banks to donate portions of their debt portfolios to charitable organizations since it adopted IRS Ruling 87-124, which allows commercial banks to write off the full face value of such donations? Is this mechanism being used? If not, what are the obstacles?

Answer. Revenue Ruling 87-124, issued in November 1987, clarified the tax consequences for banks of entering into charitable contributions of debt paper. In particular, the ruling indicated that a donor of debt paper is able to take a tax deduction both for the loss (represented by the difference between the face value of the debt and its fair market value) and for a charitable contribution (in an amount equal to the fair market value of the debt paper). In other words, the ruling made consistent the tax treatment of a bank donation of debt paper with a bank donation of the proceeds of a sale of debt paper.

Bank's decisions about whether to donate debt paper are based on a variety of considerations. While Revenue Ruling 87-124 gave banks a clarification of tax treatment and equal incentive to donate paper as to sell it and donate the proceeds, many banks still have developing country debt paper as a relatively valuable asset which they not willing to surrender based solely on the tax advantages involved.

In 1989, Treasury supported legislation aimed at making it more attractive for commercial banks to donate developing country claims for development or environmental purposes. In what is now PL 101-240, Congress calls on bank regulatory agenices to adopt uniform accounting guidance that will allow banks to value the LDC loan assets given to charity (i.e., an environmental NGO) at the fair market exchange dollar equivalent of the local currency received as a result of a debt swap transaction. Treasury has encouraged the regulators to act in a timely manner to adopt accounting guidance consistent with the intent of the law.

FINANCING FOR THIRD WORLD DEBTORS

Question. In the event that commercial bankers continue their retreat from lending to Third World countries, what do you think this implies for the role of creditor governments? Is increased foreign aid likely or do you believe creditor governments might also be required to extend debt relief?

Answer. By the end of 1988, it was readily apparent that there was widespread reluctance among commercial banks to provide new financing to developing countries, while many banks were actively reducing their LDC claims, although with no assured benefit to debtor countries. It was to address this need to sustain commercial bank financial support for debtor countries, as well as to address other problems such as capital flight and low investment, that Secretary Brady made his proposals to strengthen the international debt strategy in the spring of 1989.

In the last year, the IMF and the World Bank developed and put into place, at the urging of key creditor governments, guidelines for IFI support for debt and debt service reduction. The Government of Japan is in the process of providing $10 billion to support the strengthened debt strategy with specific commitments so far for Mexico, the Philippines, Costa Rica, and Venezuela. The United States, through USAID, has provided concessional resources to both the Philippines and Costa Rica to back debt and debt service reduction.

Creditor governments have also made substantial contributions through Paris Club reschedulings. Reflecting the medium-term horizon of the debt strategy, the focus of the Paris Club has moved to multi-year rescheduling agreements (MYRAs) to support countries with medium term IMF and World Bank programs. Since creditor governments have been willing to reschedule interest as well as principal on official loans, the official reschedulings have continued to provide the equivalent of "new money" and therefore more relief than bank reschedulings. In addition, we have encouraged official export credit agencies to go back on cover where appropriate as soon as possible after the Paris Club rescheduling to continue to provide critical trade finance to many of the major debtor countries.

The U.S. Government and other official creditors are also providing special treatment in debt rescheduling ("Toronto terms") to the least developed countries which are pursuing sound economic reform programs. In addition, the U.S. government has announced a willingness to forgive certain economic assistance loans to sub-Saharan African countries pursuing economic reform programs. Twelve countries have signed agreements for this purpose with respect to about $844 million in principal and interest, and two more countries have been declared eligible for the program.

Creditor governments have also initiated efforts to identify and, where appropriate, remove any impediments to debt and debt service reduction in their tax, regulatory, and accounting regimes. In the United States, the Securities and Exchange Commission has clarified the accounting treatment for the debt reduction bonds and debt service reduction bonds held by banks as a result of the Mexican financing package. In addition, the Department of the Treasury has clarified the tax treatment of the new bonds, in particular the determination of the amount of the tax loss.

Question. Do you believe Eastern Europe is likely to divert resources away from the struggling debtor nations of Africa and Latin America? If this occurs, what are the implications? What actions might you consider to ease the impact of such a shift?

Answer. We believe that foreign savings will be channeled to those areas providing the highest return possible and the lowest perceived risk. Investors will undoubtedly channel funds into the economies of those countries successfully implementing growth-oriented reforms. These resources are limited, so obviously these regions will be competing for them. In the final analysis, whether these resources will flow to Latin America or to Eastern Europe will ultimately depend on how successful they are in reforming their respective economies and encouraging new investment.

INTERNATIONAL FINANCIAL INSTITUTIONS AND THIRD WORLD DEBT

Question. How much money has the World Bank and IMF lent, in the past year, to help Third World countries repurchase debt on the secondary market? What types of discounts were the debtor countries able to achieve in these buy-back purchases? Overall, how much Third World commercial debt has been retired?

Answer. Six countries have thusfar availed themselves of the strengthened debt strategy: Mexico, the Philippines, Chile, Costa Rica, Venezuela and Morocco. World Bank and IMF resources have already been used to back completed debt exchanges or buybacks in Mexico, the Philippines, and Chile. World Bank and IMF loans will also back the financing packages for Costa Rica, Venezuela, and Morocco, but have not yet been drawn since these packages are agreements in principle at the present time.

World Bank and IMF resources are expected to back four different types of debt and debt service reduction arrangements: direct cash buybacks (Philippines, Costa Rica, Chile, Venezuela), collateralized debt reduction bonds (Mexico, Venezuela), collateralized debt service reduction bonds (Mexico, Venezuela), and concessional reschedulings (Costa Rica). These instruments differ in their structure, enhancement requirements, relationship to the secondary market price of debt, and impact on the debtor's economy.

Mexico: The Mexican financing package offered banks three options: (1) new lending, (2) collateralized debt reduction bonds at a 35% discount, and (3) collateralized debt service reduction bonds at a fixed interest rate of 6.25%. The principal of the debt and debt service reduction bonds will be fully secured by collateral in the form of 30-year zero-coupon bonds. Interest payments will be enhanced by 18 months of rolling interest support.

The commercial bank package generated significant debt and debt service reduction benefits for Mexico:

More than 85% ($42 billion) of Mexico's bank debt has been converted into debt service reduction bonds.

The debt reduction bonds cut bank debt immediately by about $7 billion, while the debt service reduction bonds are the economic equivalent of a further implicit reduction of $7.75 billion.

Debt service savings total $12 billion during the 1989–92 period, including interest savings of $1.5 billion per year.

Overall, the Mexican Government estimated that the net effect is that Mexico's total external debt will decline from $95 billion at the end of 1989 to the equivalent of $80 billion in March 1990.

Of this amount, future principal payments on $35 billion of Mexico's bank debt are assured by zero-coupon bonds used as collateral, thereby lifting these payments from the backs of the Mexican people.

The IMF and World Bank backed the debt and debt service reduction bonds through two mechanisms: (1) the set-aside of a portion of programmed adjustment lending to back the debt reduction bond, and (2) additional funds to be used as interest support to back both the debt and debt service reduction bonds. The IMF has thusfar disbursed $1.24 billion in enhancements to back the financing package: $640 million in set-asides and $600 million in interest support. The World Bank has thusfar disbursed $2.01 billion in enhancements: $750 million in setaside resources and $600 million in interest support. In determining Mexico's total stock of debt, the loans from the World Bank and IMF are offset by Mexico's new financial assets, namely the zero-coupon bonds and the interest support instruments.

Chile: Chile chose not to enter into broad negotiations with commercial banks because it is close to voluntary access to markets and its earlier debt/equity and buyback programs had already retired $7.8 billion in bank debt. In December 1989, Chile used $81 million from the IMF in a limited buyback to purchase $140 million in commercial bank debt at a discount of 41% (reflecting the secondary market for its debt).

Philippines: The agreement between the Philippines and its commercial banks places greater emphasis on new lending, and direct cash buyback, and bank waivers for additional debt and debt service reduction. This is because the Philippines is closer to returning to voluntary lending, its debt burden is not as heavy as other major debtors, the proportion of bank debt to total debt is only about 25%, and the impact of debt and debt service reduction alone would have been small relative to its financing needs. The Philippines completed a direct buyback of $1.3 billion in early January at a 50% discount, retiring about 20% of its medium-term commercial bank debt. The IMF provided $120 million in set-asides and the World Bank $150 million in set-asides to be used in the buyback.

Total: Disbursements from the international financial institutions to support debt and debt service reduction in the three arrangements completed thusfar amount to $3.6 billion, of which $3.25 billion have been converted into debtor assets (zero-coupon bonds and interest support instruments). The implicit debt reduction in these arrangements (including the economic equivalent of the debt service reduction bonds) amounts to about $16.2 billion.

ROLE OF IFIs IN RESTRUCTURING THIRD WORLD DEBT

Question. Do you believe the World Bank's role in helping effect a settlement of international debt arrears after World War Two might be a precedent for its possible action during the present world debt crisis? Could the Bank use its good offices and its lending powers more effectively to resolve existing debt disputes?

Answer. Although the World Bank did play an indirect role in settling outstanding government debts after World War II, the Bank's approach during its early years does not provide a precedent for an activist approach to resolving the current debt crisis.

According to the World Bank's official history, in its early years the Bank followed a policy of refusing to make loans to countries that failed to make reasonable efforts to settle overdue pre-World War II public debt. Two reasons motivated this policy. First, the Bank's management was initially preoccupied with proving the Bank's creditworthiness to the financial markets in which the Bank believed that loans to countries already in default on foreign loans would be disquieting to purchasers and potential purchasers of Bank bond. Second, the Bank believed that settlement of defaulted government debt was necessary to mobilize private capital inflows. Thus, while the Bank considered outstanding debts of applicants for loans and the applicants' willingness to meet foreign obligations, it never tried to become an intermediary between the applicant governments and foreign creditors.

More recently the Bank has taken several significant steps toward assisting in the resolution of the debt crisis. First, the Bank has long abandoned its policy of refusing to lend to countries with overdue governmental debts. In 1989 alone, the Bank disbursed over $4 billion to seventeen highly indebted middle-income countries. Such lending supported by policy advice is intended to permit heavily-indebted countries to remedy the structural problems that contributed to their indebtedness, to increase foreign and domestic investment, and to ease the burden of adjustment on the neediest classes. Moreover, in 1989, the Executive Directors of the Bank determined that the Bank should play an important role in the voluntary debt and debt-service reduction advocated by the Brady Plan. The Bank will thus not only continue to exercise its primary responsibility for helping debtor countries design and implement structural-adjustment programs in relation to any additional debt relief, but will also commit some of its resources to supporting debt and debt-service relief.

Question. Do you believe the International Monetary Fund's charter (Article VIII, Sec. 2(b)) gives the Fund the authority to endorse international debt restructuring agreements and to render unenforceable all contracts which are inconsistent with those agreements?

Answer. According to the charter of the International Monetary Fund (IMF), any definitive interpretation of a charter article, such as Article VIII, Sec. 2(b), must be made by the Executive Directors of the IMF. To date, the Executive Directors have not interpreted Article VIII, Sec. 2(b), in a way which would give the IMF the authority to endorse international debt restructuring agreements and to render unenforceable all contracts which are inconsistent with those agreements.

Absent such an interpretation by the Executive Directors, Treasury is unable to say that it believes that Article VIII, Sec. 2(b), gives the IMF the authority to render unenforceable all contracts which are inconsistent with international debt restructuring agreements endorsed by the IMF.

Interpreting Article VIII, Sec. 2(b), as giving such authority to the IMF would raise a number of very complicated, controversial issues which do not appear to have been contemplated by those who drafted the IMF charter or by the Congress when it passed the legislation approving U.S. membership in the IMF. Moreover, given the wording of Article VIII, Sec. 2(b), any interpretation could well leave holes so that the IMF would be authorized to render unenforceable some, but not all, contracts which are inconsistent with international debt restructuring agreements which it has endorsed.

According to the IMF, the authority described in the question could have a great impact on a number of existing debtor-creditor contracts and could give rise to extensive litigation. Currently, there does not appear to be extensive support among the member countries of the IMF for the IMF to be given such authority.

Question. In the absence of an international bankruptcy court, are not the World Bank and the IMF the logical institutions for sorting through the conflicting claims of the creditors, suppliers, debtors, and the citizens and governments of the countries involved in order to find a propitious settlement? Is this not the next logical step in the evolution of the Brady Plan?

Answer. This question raises legal issues similar to those raised by the previous question concerning the IMF's authority to endorse restructuring agreements and render unenforceable all contracts inconsistent with those agreements.

The various legal claims against the debtor countries mentioned in your question arise under a multitude of national legal systems and under international law. For example, United States courts have determined that New York law governs many loan agreements between New York banks and debtor governments. The debtor country's law may govern certain other loans and supplier agreements, and international law governs bilateral and multilateral official loans. To play the role of an international bankruptcy court, the World Bank and IMF would need the legal authority to void or, at least, reform legal claims under all these legal systems.

As discussed in the previous question, the Executive Directors of the IMF have never interpreted the IMF's Articles of Agreement to give the IMF the authority to render unenforceable all contracts that are inconsistent with certain restructuring agreements. In addition, there is no provision in the World Bank's charter that would empower the World Bank to act as a bankruptcy court.

The authority necessary to carry out the function described in this question would have significant impact on numerous existing debtor-creditor contracts, judgments, and other claims and could give rise to extensive litigation. Such extensive litigation is avoidable because of procedures already in place to deal with the renegotiation of debt. For commercial bank debt, the debtor nation negotiates directly with the creditor bank on new repayment terms, interest changes, and fees. Any bilateral official debt is rescheduled within the Paris Club. There, face-to-face negotiation procedures have been successful in rescheduling debts without the control and involvement of third-parties.

THE PARIS CLUB AND THE DEPT BURDEN

Question. Mr. Secretary, since 1980, we seem to have a hyper-active Paris Club constantly rescheduling official debts to countries with problems meeting their debt payments.

The State Department has told the committee that from January 1980 to April 1989, 117 Paris Club agreements have negotiated for 45 different countries—that averages 2.6 Paris Clubs per country. However, some countries have gone to Paris Club 5 or 6 times.

Paris Club reschedulings have been used to help countries such as Egypt avoid being in default to the U.S. and thereby loosing their foreign assistance because of the Brooke Amendment.

What concerns me, Mr. Secretary, is that I see Governments using the Paris Club process to avoid facing the reality that some countries debt problems are impossible to grow out of and can only be resolved through deep private and official debt reduction.

How long do you think that it will be before we have countries primarily with official debt—outside of Africa, where it has already happened—that default on that official debt simply because no matter how disciplined they are in denying their populations simple necessities they find it impossible to earn enough hard currency from exports to meet their debt payments?

Answer. The Paris Club is designed to help countries that experience financial difficulties due to an unusually heavy concentration of debt service payments falling due within a short period of time. The Paris Club provides relief by "rescheduling" those payments over a longer, more manageable repayment period; it is not normally the Paris Club's function to forgive debt.

However, the major industrial countries agreed at the Toronto Economic Summit in 1988 to offer various forms of extraordinary debt relief, including partial forgiveness of official loans, interest reduction, or exceptional 25 year rescheduling options to those least developed countries in Sub-Saharan Africa that were pursuing sound economic reform programs. Separately, the United States offered to forgive certain development assistance loans to heavily indebted sub-Saharan African countries with economic adjustment programs in place. These steps were taken in recognition of the fact that the burden of debt on some of these small economies had become too heavy to bear.

The great majority of debtor governments that have used the Paris Club process for rescheduling their official debts have done so responsibily. While several have had to request reschedulings more than once, that should not be surprising when dealing with debt problems of the severity of some we have seen. Moreover, reschedulings normally address debt coming due in a 12-18 month period. More recently, the Paris Club has agreed to provide multi-year reschedulings in conjuction with medium term IMF and World Bank reform programs and medium term commercial bank packages encompassing debt reduction in order to better address financing needs over a longer period. To guard against abuse we are also working to design closer linkages between Paris Club relief and improved economic performance by the country receiving the relief. As always, we believe that such linkages will have to be designed on a case-by-case basis in order to take adequate account of the circumstances of each debtor country.

Questions for the Record Submitted by Mr. McHugh

INTERNATIONAL MONETARY FUND

Question. Could you explain in more detail the proposal you have put forward that would encourage the International Monetary Fund to sell a portion of its gold to deal with the problem of certain countries that are in arrears in the repayment to the Fund?

Answer. The United States has proposed a comprehensive plan for strengthening the IMF arrears strategy. Arrears to the IMF by 11 countries currently total approximately $4 billion. In order to maintain the financial integrity of the IMF, the U.S. has tabled proposals covering the following key elements: 1) remedial measures, 2) preventative measures, and 3) incentives for countries with protracted arrears to eliminate their overdue obligations. We have proposed a limited mobilization of Fund gold to help finance incentives for arrears countries to reform their economies and earn the "rights" to eliminate their overdue obligations. The amount of gold mobilized would reflect the gold subscriptions of the arrears countries—2-3 million ounces out of total Fund gold holdings of 103 million ounces.

In order to earn the "rights" to financing generated by the gold mobilization, a country would need to perform successfully under a Fund-monitored program for a period of perhaps up to 3 years. In addition, the country would have already had its voting and representation privileges suspended and lost its rights under IMF articles to any residuel claims on the IMF's gold. However, at the end of the performance period, the country, after restituting its portion of the Fund's gold, would gain access to those resources generated from the gold mobilization, could then clear its arrears, and normalize relations with the IMF.

Question. What has been the response of the management of the Fund to this proposal?

Answer. There is wide support for the U.S. objective of strengthening the arrears strategy as part of quota review. Members also support the broad elements of the U.S. proposals: 1) preventative measures, 2) remedial measures, and 3) incentives for performing countries to clear their arrears. Debate has focussed on the financing for incentives. Some have supported our gold proposal. Others have put forward different ideas, such as using quota-based or concessional resources. We have been concerned that any use of quota-based resources to finance incentives would amount to a rescheduling of overdue obligations, establishing a bad precedent and undermining the Fund's monetary character.

Question. Among the countries that the proposal is intended to help are some, such as Liberia, Somalia, and Sudan, ruled by governments that seem to have absolutely no concern for the plight of their poor majorities or for sound economic management. Why would we want to assist countries like these?

Answer. The primary purpose of the strengthened arrears strategy is to safeguard Fund resources and ensure the credibility of the fund's revolving, monetary character. The best way to protect the Fund is to ensure that members implement strong and comprehensive adjustment programs. Sound economic performance and adjustment are a prerequisite for growth and for addressing the widespread problems of poverty. Our proposals for a strengthened arrears strategy would provide enhanced incentives for countries to adjust. We want to encourage and reward sound economic management needed to alleviate poverty.

Question. What evidence is there that these countries are prepared to change their policies?

Answer. The purpose of the U.S. proposal is to create incentives for all arrears countries to implement reforms necessary to bring about growth-oriented adjustment and normalize relations with the international financial community. For these countries to tackle their problems, they will need to adopt an appropriate mix of adjustment and financing, supported by the international community. We hope that these countries will recognize this basic reality and respond to the incentives offered under our proposals.

Question. Assuming the short-term problem facing the Fund is resolved, what happens if these countries continue to accrue arrears to the Fund in the future? Would we encourage further sales of gold?

Answer. The gold mobilization proposed by the United States is a one-time offer to help arrears countries restore sound economic policies and normalize relations with the IMF. The gold to be mobilized is deliberately limited—linked to the gold subscriptions of those with arrears. No mobilization of additional gold is contemplated.

Question. Are there any other proposals under consideration for dealing with the problem of those nations with heavy arrears to the Fund?

Answer. Throughout the negotiations, the United States has made clear that any increase in IMF quotas, being deliberated under the Ninth Annual Review of Quotas, is contingent on a strengthening of the arrears strategy. We intend to ensure that any increased U.S. contribution to the IMF is used wisely. A number of proposals have been made to strengthen the arrears strategy. Nearly all incorporate the concepts present in the U.S. proposal, namely the need for remedial measures, preventative measures, and financing to eliminate the arrears of countries performing for a period of time under a Fund-monitored adjustment program. Regarding the financing of arrears, suggestions have included the use of Fund General Resources and concessional facilities. Various ideas on mobilizing gold have also been examined. The IMF Executive Board's active deliberation of these issues reflects the high priority granted this issue.

Question. Could you bring us to date regarding negotiations for a quota increase in the Fund, and when you would be expecting to seek congressional approval for such an increase?

Answer. We expect agreement on a quota increase in the near future, certainly in time to meet the June 30, 1990, deadline. Given that we have not yet concluded the negotiations, no final decisions have been reached on when to seek congressional approval.

EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

Question. One of the arguments that we heard from the Department last year during the course of negotiations over the IDA 9 replenishment was that the United States could not support an increase in real terms over and above the level of the IDA 3 replenishment because of a tight budgetary situation. Instead, we were told that at best the United States could only support an increase that would maintain the purchasing power of the IDA 8 Replenishment. Could you explain why funds are now available for the United States to participate in the capitalization of the European Bank for Reconstruction and Development? In particular, has the budgetary situation changed in any significant manner?

Answer. The budget situation has not changed. The Administration's FY 1991 budget request includes $300 million to respond to the changes in Eastern Europe as these countries progress to more democratic political structures and market-oriented economies. The first $70 million paid-in installment for U.S. participation in the EBRD will come out of the $300 million that was included in the FY 1991 budget request. We are preparing to send Congress a budget amendment to that effect.

Question. Other than the fact that the Europeans, particularly the French, want a new institution, what is the justification for creating a new institution, especially one where paid-in capital will be so high? Why can't existing institutions do the job?

Answer. There is a strong desire on the part of the Europeans to create a regional MDB to aid Eastern European countries. The motivations for creating the "regional" EBRD is the same as those that prompted creation of the other regional MDBs—the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank—i.e., a mixture of economic, financial, and political rationales. Other, existing institutions might well be able to do the job if there was a broadly based, wholehearted commitment to use them for that purpose and contribute funding.

Question. Other than simply having a seat at the table when decisions are made, what concrete reasons are there for the U.S. to participate in this new institution?

Answer. Having a seat at the table when decisions are made is not a trivial matter. It will afford us the opportunity to seek to ensure that the institution functions in a manner consistent with the private sector oriented objectives we have achieved in negotiating the bank's Articles of Agreement. There is also a political dimension. Joining the EBRD demonstrates our strong interest in supporting the newly emerging democracies in Eastern Europe and our solidarity with Western European countries.

Question. What is our position regarding EBRD lending to the Soviet Union.

Answer. We would have preferred that the Soviets not be borrowers. However, some of the European governments supported giving the Soviet Union the same borrowing privileges that will be accorded the Eastern European countries. I believe that limited Soviet borrowing to the amount of their paid-in capital is an acceptable compromise. In essence, the Soviets will only be borrowing back the money they must put up to join the EBRD.

Question. Will the EBRD lend at market or concessional rates? What will the repayment schedule look like? Will our contribution be in dollars or the dollar-equivalent of ECUs?

Answer. The EBRD will lend at market-related rates, but it is too early to say what the repayment schedule might be. The U.S. contribution would be in dollars and would be a fixed commitment based on the average U.S. dollar/European Currency Unit (ECU) exchange rate over a specified time-period.

Question. Some critics have argued that the Bank cannot succeed unless the debt problem of the Eastern European countries, particularly Poland, is addressed? Does it make any sense to pile more debt on to a country like Poland?

Answer. The Poles will need external financing if their efforts to restructure their economy are to succeed. To help provide this assistance it has been U.S. policy to support extremely generous Paris Club reschedulings for them; and, to seek new official flows in the form of grants or highly concessional loans and commercial bank debt reduction. This assistance, combined with sustained implementation of their reform program, will fundamentally improve Poland's financial prospects.

NICARAGUA

Question. Nicaragua owes $172.7 million in arrears to the World Bank and $56.8 million in arrears to the Inter-American Development Bank. Unless those arrears are repaid, the new government of Nicaragua will not be eligible for new lending from these institutions. How much of the proposed Nicaraguan supplemental is designed to address this issue?

Answer. $50 million.

Question. Where do you expect the rest of the money to come from?

Answer. We expect other donors to make up the difference.

BRADY PLAN

Question. This Subcommittee heard testimony recently from Jeffrey Sachs that your debt strategy is not working—that it has been very limited in terms of the number of countries participating, that the relief packages, particularly for Mexico, are not commensurate with the needs of the indebted countries, and that we are going to be back to square one within a very short period of time. How would you respond to those criticisms?

Answer. The current debt strategy has already produced impressive agreements with significant debt reduction for six countries. These countries account for 46 percent of the total commercial bank debt of the 16 major debtors (the Baker 15 plus Costa Rica). We expect Brazil, with 28 percent of bank exposure, to also seek discussions in the near future. Once these Brazilian discussions are concluded, more than three-fourths of commercial bank exposure to the major debtors will have been addressed under the new strategy. The strategy has also reinvigorated debtor countries' reform efforts and encouraged the adoption of measures to attract new investment and capital repatriation, as alternative sources of private capital. Official creditors are also doing their part through multi-year reschedulings of principal and interest within the Paris-Club, new grants, and export credits.

Question. You are requesting a supplemental for callable capital for the World Bank. What happens if we do not approve it?

Answer. The United States is in jeopardy of dropping below the 15 percent veto threshold (over amendments in the World Bank Articles of Agreement) as long as our outstanding shares from the last general capital increase remain unpurchased. Maintaining the veto is important to U.S. leadership and control over some key financial issues. If we purchase no shares by June 30, 1990 our voting power could drop to 14.9 percent.

IMF ENHANCED STRUCTURAL ADJUSTMENT FACILITY

Question. In simple terms, what, if any, contributions has the IMF ESAF made in terms of alleviating the debt problems of the poorer developing countries? Please be specific using Ghana as an example.

Answer. The IMF Enhanced Structural Adjustment Facility (ESAF) provides financial assistance at concessional terms to lower income countries. It substantially enlarges concessional resources available to low income countries seeking support for comprehensive growth-oriented adjustment. As of November 1989, 11 countries had ESAF arrangements totaling $1.8 billion.

ESAF programs benefit borrowing countries by (1) supporting comprehensive reforms necessary for sustained economic growth, (2) providing needed financing at favorable terms, and (3) acting as catalysts for expanded international assistance. The ESAF builds on intensified IMF and World Bank collaboration developed under the Structural Adjustment Facility (SAF) through the establishment of Policy Framework Papers (PFPs). The PFP process required for an ESAF program has provided the basis for substantial World Bank support for adjustment in low income countries. In addition, poor countries implementing reforms under an ESAF program are eligible for rescheduling from Paris Club creditors.

On November 9, 1988, the Fund approved an ESAF arrangement with Ghana. The ESAF program supports on going reform efforts in Ghana, begun early in the 1980s, and includes structural measures to further liberalize trade, improve the efficiency and equity of the tax system, accelerate state enterprise reform, pursue a flexible exchange rate policy, and liberalize interest rates. Ghana's reform efforts have already led to an increase in growth and per capita income. Further growth-oriented reforms, along with appropriate fiscal and monetary policies, will contribute to achieving the macroeconomic objectives of the 1989-91 program: (1) real annual economic growth of 5 percent, (2) reduced inflation (to 5 percent), and (3) substantial balance of payments surpluses (averaging $117.5 million per annum). In addition, the ESAF supports the government's special program of actions (RAMSCAD) to mitigate the social costs of adjustment.

ESAF financing committed under the arrangement totals $486 million. Perhaps more importantly, by signaling the international financial community of Ghana's commitment to sound economic management and growth-oriented adjustment, the ESAF has catalyzed significant outside assistance. Inflows of private direct investment, for example, are anticipated to rise significantly during the program period. Donor assistance is expected to increase, based on the favorable outcome of recent meetings of the Consultative Group for Ghana. In addition, significant World Bank lending is likely to continue. These resource flows, in addition to economic gains derived from the ongoing market-based reforms, illustrate the significant contributions the ESAF has made toward alleviating Ghana's debt problems.

STRUCTURAL ADJUSTMENT

Question. Some poor countries have taken many difficult steps, but their economies have simply not responded very well because of factors over which they have little control, such as world commodity prices. One good example is Ghana. What do we do to show countries like Ghana that adjustment has something to offer in terms of improving the lives of the poor majority?

Answer. The recent World Bank's report entitled "Report on Adjustment Lending" underscores the fact that countries adopting adjustment programs have on average grown faster than other countries; also that "after taking account of the effects of initial conditions, external shocks, and the amount of external financing, the countries that entered full-fledged adjustment programs had a larger increase in the average rate of GDP growth than other countries." In the case of Ghana, annual GDP growth, which averaged 1.4 percent the 1980-87 period, is currently increasing at an annual rate of close to 6 percent.

The Bank's Adjustment Report recognizes that when an economy has to adjust to adverse external shocks or the effects of previous policy mismanagement, some short-run social costs are usually inevitable; also that adjustment is taking longer in most countries than originally expected. As a consequence, recent Bank adjustment operations (which the United States and other members of the Board have supported) include more measures to alleviate the short-run costs of adjustments to the newly unemployed and the poor. Such measures include reallocations of social expenditures toward services used by the poor, severance payments and retraining for newly unemployed workers, and public works and employment schemes for unskilled workers. In some cases, several targeted interventions have been assembled into multisector compensatory programs.

Question. Last year this committee included report language commending the Treasury Department for working with environmental organizations to develop standards for evaluating the environmental impact of proposed MDB loans. We also urged the Department to work with religious and nongovernmental organizations to develop standards for assessing the social impact of MDB loans. Have any steps been taken to develop social impact standards?

Answer. By collaborating with governments and other international organizations on the collection and use of social indicators, the World Bank is refining its ability to use social indicators in both policy dialogue and lending decisions. Programs such as the Living Standards Measurement Survey, and the Social Dimensions of Adjustment (SDA) Project specifically seek to improve collection of household data relevant to policy and program design, and to factor in the social dimensions into the formulation of economic policies.

As part of the effort to strengthen the link between project design and poverty reduction, the Bank has also established, beginning in FY 1990, a new internal system for identifying the extent to which Bank activities are expected to directly benefit the poor. In addition, evaluation reports on completed projects continue to address the projects' impact on the poor.

Nevertheless, the social impact of MDB operations remains difficult to measure because so many other factors (e.g. domestic policies, institutional and managerial capacity) also influence poverty reduction efforts in a major way. This underscores both the importance of focussing on the whole range of government policies as they affect the poor and establishing a strong linkage between aid allocation and the extent to which governments' overall policies reflect a meaningful commitment to poverty reduction. In this context, it should be noted that the IDA-9 Report specifically supports:

Greater weight in allocating resources to governments' commitment to poverty reduction;

Encouraging measures to protect the poor during periods of adjustment; and

Expanded support for human resources development, and for borrowers' efforts to develop better targeted poverty intervention.

THURSDAY, MARCH 15, 1990.

PROMOTING POLITICAL STABILITY, DEMOCRACY, AND ECONOMIC OPPORTUNITY

WITNESSES

REGINALD BARTHOLOMEW, UNDER SECRETARY FOR SECURITY ASSISTANCE, SCIENCE AND TECHNOLOGY, DEPARTMENT OF STATE

PAUL WOLFOWITZ, UNDER SECRETARY FOR POLICY, DEPARTMENT OF DEFENSE

MARK L. EDELMAN, ACTING ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT

DAVID C. MULFORD, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

CHAIRMAN'S OPENING STATEMENT

Mr. OBEY. Good morning. I am going to try to start this hearing on time because I have to be in three places at the same time this morning. I would like to move forward as quickly as we can today. Gentlemen, I will have a very short opening statement. I assume Mr. Mulford will be here shortly. I ask each of you to summarize your statement in about five minutes. We will print the full statement in the record, then proceed to as many questions as we can squeeze in during the limited time we have this morning.

ADMINISTRATION'S FOREIGN AID REQUEST

Today we will hear from a host of Administration witnesses, led by Under Secretary of State Reginald Bartholomew, to address the overall question of how the Administration's request for $15.3 billion in foreign aid promotes political stability, the growth of democracy, and the growth of economic opportunity around the world.

The request before us is $15.3 billion. It is, in my judgment, a status quo budget in contrast to a rapidly changing world environment. The request is, with a few small exceptions, roughly the same budget which the administration asked the committee to approve last year. The budget moves around a very small percentage of money within it. It represents an increase of five percent over amounts provided last year—an increase of $810 million in discretionary spending. Of that amount, well over half $500 million, is for military and security-related assistance—$350 million in the military, and $150 million in ESF.

By contrast, amounts requested for development assistance have actually declined by about $15 million. Amounts requested for export-related programs have declined by $112 million, a fifteen percent reduction from last year. Some international programs, for instance programs for children such as UNICEF and programs for the environment have been reduced significantly in the request.

The level requested for military assistance funding represents a sixty percent growth from the amounts requested for military assistance since 1981.

In addition, the military programs are further enriched under the Administration recommendations by converting the last remaining $406 million in military loans to grants. These programs started as all loan programs at market rates of interest. They were then gradually converted to partial concessionary loans at lower interest rates and partial, full interest rate level loans. Then they were converted partially to forgiven loans or in plain English, outside the beltway language—that means grants.

We have now gotten to the point where only about $400 million in loans remain. The Administration is asking us to eliminate that and make it all grants.

In addition, the Administration is planning to make ample use of authority allowing excess and aged U.S. military equipment to be available to the Third World. Further, a review of potential, upcoming commercial sales indicates a continuation of the ever-expanding arms sales to Third World countries, some of whom, in my judgment, cannot afford that level of expenditure. In short, gentlemen, a year when the Soviet military alliance has collapsed, the Administration's response is to call for a marginal increase in military spending and a status quo budget elsewhere.

What baffles me is this. We are being asked to provide a supplemental which will be a very large increase in foreign assistance. We are being asked to do that by the Administration.

There is bipartisan agreement, for instance, that we ought to provide significant assistance to Nicaragua. We have spent over $300 million to finance the Contra operation. We are being asked to spend $300 million more or so to provide assistance to Nicaragua.

What bothers me is that our country always seems to be in a position where we are paying a great deal of money to clean up problems. We do not invest nearly enough thought or resources to prevent those problems from coming about in the first place. I cannot think of a year in my lifetime where we were presented with a greater opportunity to do that than this one. Frankly, gentlemen, if the Administration or this committee do not make significant changes in the pattern of the usual foreign aid requests. the process is going to run away from both of us. I have no doubt the House and the Senate will insist on significant changes. So I hope that today we can talk about this.

Secretary Baker said, for instance, we have to understand this budget was presented several months ago. We recognize things have happened since then.

I want to talk today about how we might agree upon changes in the budget which would reflect the major changes we see all around us, including major changes in the Soviet thrust in the Third World.

Let me simply stop talking and ask each of you to summarize your statements in five minutes. Then we will proceed to the questioning.

I apologize because at some point I am going to have to leave to go to another hearing down the hall. I will stay here as long as I can.

We have with us today Reginald Bartholomew, Under Secretary for Security Assistance, Science and Technology; David C. Mulford, Under Secretary for International Affairs; Paul Wolfowitz, Under Secretary for Policy from the Department of Defense; and from A.I.D. Mr. Mark L. Edelman, Acting Administrator. Gentlemen, if I could ask you to proceed.

Mr. Bartholomew, do you want to start?

MR. BARTHOLOMEW'S OPENING STATEMENT

Mr. BARTHOLOMEW. Mr. Chairman, I, for one, am grateful for the opportunity to come here today and talk with you.

Secretary Baker made very clear how interested we are in working with you, and I want very much to follow up on that. With four witnesses I am going to see if I cannot summarize my statement for you in less than the five-minute mark that you set.

Mr. OBEY. House members never accomplish that. [Laughter.]

Mr. BARTHOLOMEW. Let us see if this Administration witness can.

The theme you have set for this hearing does not just involve today's issues which we are all reading about in the papers. It does, in fact, go to the heart of American foreign policy. I would say through the whole course of the postwar era that, in fact, protecting and promoting political stability, democracy and economic freedom in the world has been a central purpose of our foreign policy. It has been so consistent throughout and in the face of all the change we are seeing, and it will remain so.

Mr. Chairman, you know—we all know that in the past decade, indeed in the past year, indeed in the past six months we have seen these values gain ground, with a scope and rapidity that I think surpasses anyone's prediction.

I do not think I need to recapitulate them. I think I would underscore what we all sense, the great prospects and opportunities they open before the nation, our nation and others.

At the same time, Mr. Chairman, I think we would all agree that the world is not yet a perfect place. The positive change that is underway is not yet complete, and change of that order and that importance typically brings with it its own uncertainties and stresses.

There still remain regional conflicts, regional disputes and differences that bear importantly on our interests, our values.

We have new problems in forms that have come to the fore in recent times, in the form of international drug trafficking which threatens the values that we are talking about, political stability, democracy and economic freedom of the nations that are caught up in it and which threatens the security and well-being of our own country.

And, of course, we face new dangers—I would underscore this—new dangers in the proliferation of weapons of mass destruction, not only the nuclear weapons, but chemical weapons as well, together with the potential spread of missiles capable of launching these weapons on hair trigger notice.

That said, Mr. Chairman, I think that the whole world can take considerable encouragement from the developments that we see underway. I think the American people in particular can take considerable pride and satisfaction in these developments because our efforts since World War II—not taken by ourselves alone but reflecting American leadership—have been absolutely critical in bringing us to this point, in creating a framework that helped bring us to this point and that will help carry us further from here.

By a framework I am referring to central elements, consistent elements of our policy that have been followed over the course of forty years, with great continuity by all administrations since World War II.

I speak of strong alliances, starting with NATO, and the close friendships and bilateral relations we had with key countries around the world, our strong military forces at home and abroad, the effective foreign assistance programs that we have pursued, and the persistent efforts of all American administrations to try to promote East-West dialogue and arms control and try to promote the peaceful resolution of regional conflicts.

Mr. Chairman, the issues you in Congress and we in the administration will be wrestling with as we address the foreign aid program are part of the larger question we are wrestling with and that you touched on in your opening remarks.

FOREIGN POLICY PRIORITIES

Stated broadly, how do we design and adapt our policies, our programs to meet the demands of—let me call it this newly promising though still imperfect world.

We will be able to differ, I think, as to the specifics of what the United States should do in each situation. But surely there ought to be a fair degree of consensus about the basic outlines that ought to shape our approach.

I think we should be able to agree that we should shape our policies to do three things: First, to sustain and further the positive change that we are seeing, and to ensure against the difficulties, the uncertainties it can bring; second, to deal with the problems that have not changed and the new dangers that I referred to that have arisen and, third, to maintain the framework that I described above that has been important in getting us to this point even as we adapt the program, the framework to the new conditions.

These, Mr. Chairman, are the guidelines that shape the fiscal year '91 budget that we have put before you.

As a final remark, Mr. Chairman, I want to note what Secretary Baker said before this committee in concluding his testimony. He cited the need for greater flexibility in foreign assistance balanced by accountability and sound management in order to make the administration of our foreign policy more effective.

He proposed a new code of conduct in which we would look at constructive consultation as the primary vehicle for achieving consensus on prime objectives.

Mr. Chairman, we stand ready to work with the subcommittee to that end, and I say that, Mr. Chairman, with full appreciation for your own efforts over the years to limit the practice of excessive earmarking.

Mr. Chairman, we think that the President's balanced approach to the fiscal year '91 foreign assistance budget that we have put before you today is the right response for today, one that carefully nurtures positive change. It deals with continuing problems, and it does strengthen the framework that will ensure stability during this time of transition. Thank you, Mr. Chairman.

[The prepared statement of Mr. Bartholomew follows:]

TESTIMONY

OF

THE HONORABLE REGINALD BARTHOLOMEW

UNDER SECRETARY OF STATE

FOR SECURITY ASSISTANCE, SCIENCE AND TECHNOLOGY

BEFORE

HOUSE APPROPRIATIONS SUBCOMMITTEE FOR FOREIGN OPERATIONS

THURSDAY, MARCH 15, 1990

Mr. Chairman, thank you for the opportunity to address you and the members of your subcommittee today.

The theme you have set for this hearing goes to the heart not just of today's issues, but of American foreign policy itself.

Protecting and promoting political stability, democracy, and economic freedom in the world has been and will remain a central purpose of US foreign policy in the post-war era.

--We pursue these goals because we as a nation think they are right, and because we think we have a responsibility to espouse the values they represent.

--We pursue these goals because we believe that a world characterized by these values is the best environment for our own security and well-being -- economic, political and social.

Mr. Chairman, in the past decade, in the past *year*, we have seen these values gain ground with a scope and rapidity that has surpassed anyone's predictions.

--The Soviet Union has begun a wrenching swing towards these values.

--Domestic dictatorship and foreign domination in Eastern Europe are giving way to the emergence of new democratic and independent states.

--Africa is witnessing a dramatic evolution marked by the emergence of an independent Namibia, the spread of market-based economies over half the continent, and new hope for positive change in South Africa symbolized by the release of Nelson Mandela.

--In Asia, in Pakistan, the Philippines and South Korea we have nations building new democracies and economic freedom and striving to build firm foundations for political stability.

--Close to home in Latin America, the whole political complexion of the continent has changed through the decade of the '80s toward democracy and economic freedom.

--In Panama and Nicaragua, dictatorial governments have been rejected by their peoples and the work of constructing political stability, democracy and economic freedom is underway.

Mr. Chairman, it is true that the world is not yet a perfect place:

--The positive change that is underway is not yet complete. And like all such far-reaching change it brings with it its own uncertainties and stresses.

--There remain regional conflicts and differences in the world that bear importantly on our values and on our strategic interests.

--International drug trafficking threatens the political stability, democracy and economic freedom of the societies caught up in it and the well-being of our own nation.

--And we face new dangers in the proliferation of weapons of mass destruction, not only nuclear but chemical weapons as well, together with the potential spread of missiles capable of launching them on hair-trigger notice.

That said, Mr. Chairman, the whole world can take strong satisfaction and strong encouragement from the stunning progress that has been made toward political stability, democracy and economic freedom and the prospects and opportunities before us. And I believe the American people can and should take special pride and satisfaction in these developments.

The US did not single-handedly bring about the positive developments now underway. But the efforts of the US since World War II have been absolutely critical in creating and maintaining a framework that protects and promotes these values and helps create conditions in which they can thrive. That framework includes:

--Strong alliances, starting with NATO, and close friendships and bilateral relations with key countries around the world.

--Strong military forces at home and abroad.

--Effective bilateral and multilateral foreign assistance programs, including training.

--And persistent efforts to promote East-West dialogue and arms control and peaceful resolution of regional differences around the world.

The focus of this hearing is on foreign assistance. But the issues you in Congress and we in the Administration must address in reviewing our foreign aid program are part of a larger question we are both wrestling with. Stated broadly, how do we design and adapt our policies and our programs to meet the demands of this newly promising though still imperfect world?

Opinions can and do vary, even within the Administration, on what specifically the US should do in each specific situation. But, surely, there should be a fair degree of consensus about the broad guidelines that ought to shape our approach. We need to shape our policies to:

--Sustain and further the positive change underway and insure against the uncertainties and difficulties it can bring.

--Deal with the problems that have not changed and new dangers that have arisen.

--Maintain the framework that has been and will remain essential to the positive change we want to sustain and further, even as we adapt the framework itself to the new conditions that are emerging.

Mr. Chairman, these are the guidelines that shape the FY 1991 budget before you.

We believe that the program before you is a solid answer to the question of what the nation can and should do in foreign assistance in FY 1991.

Against this background, let me outline the major elements.

Europe

Let me begin with a discussion of the assistance package we are requesting for Europe, since the most dramatic political and economic transformations are taking place there. Our request for Europe has two parts: aid for the profound changes under way in Eastern Europe, and continued support for our friends and allies in NATO.

As you know, we have requested $300 million in special economic assistance for the countries of Eastern Europe. As for the programs which we initiated in FY90 in Poland and Hungary, we propose to tailor our aid to the region to areas in which the U.S. has a comparative advantage.

A principal focus of our aid efforts will be in technical assistance and institution building. There is a critical need for the kinds of skills relevant to managing affairs in a free market system. The first order of business is to encourage policy reforms that would allow these economies to operate on a market basis and investments in the private sector that would make them flourish.

The collapse of Marxism/Leninism has made obsolete existing institutions governing economic and political life alike. To address this vacuum, our program will support for democratic institutions, including those that will promote the conduct of free elections and advance political reform through the rule of law.

In assisting Eastern Europe's transition to a free market system, the cooperation of our own private sector will be key. Our program is designed to encourage substantial private sector involvement. The tools we propose to use to ease the entry of U.S. private enterprise into Eastern European markets range from negotiation of bilateral trade and investment treaties and the granting of most favored nation treatment to establishing eligibility for EXIM, OPIC and CCC guarantees.

Finally, recognizing that the transition to a democratic, market-oriented system may be traumatic, we are prepared to offer a third level of aid, in the form of transitional economic support. In Poland, the U.S. took the lead in establishing a Stabilization Fund which was designed to help the Polish Government's bold efforts to stabilize its economy through a stiff dose of market disciplines. We are also proposing measures to help raise capital to stimulate private sector development.Those measures may be bilateral, as we have proposed through the "enterprise funds" for Poland and Hungary, or multilateral, possibly through a new development institution such as the proposed European Bank for Reconstruction and Development.

Mr. Chairman, I should note that the provision of U.S. aid to a country in transition is not automatic. We plan to base our aid on the extent to which the recipient is truly taking steps toward the achievement of four objectives in our mutual interest:

--There must be progress toward political pluralism, based on free and fair elections and an end to the monopoly of the Communist Party.

--There must be progress toward economic reform, based on the emergence of a market-oriented economy with a substantial private sector.

--There must be enhanced respect for internationally recognized human rights, including the right to emigrate and the right to speak and travel freely.

--We want a willingness on the part of each of these countries to build a friendly relationship with the United States.

In deciding on the level and mix of assistance that we provide to each individual country, we shall be influenced by their movement toward these objectives.

In looking to support a Europe in transition, we must not neglect the framework that created the conditions which made that transition possible. For more than 40 years, NATO has been the central element of that framework of stability in Europe. NATO has advanced positive political change by performing four functions:

--It has maintained a balance of military power that deterred not only war, but also coercion backed by military power.

- It has fostered solidarity among European states, by encouraging new forms of cooperation among its members.

--It has built a strong trans-Atlantic community to the benefit of both the United States and Europe.

--It has been a major platform and principal agent in pursuing East-West dialogue and arms control, moving us from confrontation to cooperation.

NATO needs to continue to perform these functions to remain a force for the consolidation of change and act as the foundation for further change.

That is the principal rationale for the programs in the Southern Flank of NATO - programs which our allies believe they need, and that we think make sense in terms of NATO's purposes. But I wish to emphasize that these programs are important not only in terms of how they help rationalize the Alliance's collective effort, but also in terms of how they fit with the bilateral defense relationships that these allies maintain with the United States. - including the maintenance of military bases. For these reasons, we have requested $1.02 billion in Foreign Military Financing (FMF) and $95 million in Economic Support Funds (ESF) for Turkey, Greece, and Portugal.

Central America

There has been a surge towards democracy in our own hemisphere as well. This week, as a freely-elected government in Chile assumed power after nearly 17 years of military rule, and a civilian President assumed office in Haiti with the promise of returning that country to democratic government, there may soon be only one dictatorship left standing in the Western Hemisphere.

The election of a democratic government in Nicaragua and the restoration of democracy in Panama are of particular significance to our foreign policy interests in the hemisphere. Mrs. Chamorro's election opens the way for fulfillment of the dream of the Central American peace process-- peace and democracy in all the nations of the region. In addition, the return of democracy to Panama - most welcome in and of itself - also cuts off an important base to drug traffickers, who have taken center stage as the biggest threat to democratic rule in the Americas.

We have a special role in aiding the return to democracy in this Hemisphere. To underscore that role, in January the President sent forward a $500 million supplemental aid request for Panama, and he just this week he submitted to the Congress a $300 million request for an assistance program for Nicaragua as a Supplemental appropriations request for FY 1990.The President has asked that the Congress consider the request for Nicaragua with the request he had previously submitted for Panama. Because of the urgent need facing both countries, the President has asked that the combined Supplemental request be forwarded to him for signature by April 5. The Administration stands ready to cooperate fully with the Congress to assure that a mutually agreeable package of offsets is identified by March 27, and that the funds can be made available as a matter of highest priority.

In addition to the supplemental aid for FY 1990 outlined above, we have asked for a total of $739 million in foreign assistance for the Central American democracies in FY 1991, four-fifths of which is economic aid. Our request will allow us to support the framework for democracy, and for a lasting peace in the region, represented by the Esquipulas, Tesoro Beach and Tela accords. With democracy clearly in ascendance, we have today an unprecedented opportunity to effect a profound and positive change in this critical region, to contribute to the expansion of regional peace and to the consolidation of democracy. As Secretary Baker said in appearing before you two weeks ago, the success of our efforts depends on the ability of our Government to speak with one voice during the weeks and months ahead. To that end, the Administration welcomes the opportunity to work closely with the Congress in the formulation of our response to developments.

Anti-narcotics Programs

In contrast to the positive evolution towards democracy in this hemisphere, one trend is negative. The greatest threat to democratic values and stability in this hemisphere today is the traffic in illegal drugs. In the last decade in Colombia alone drug traffickers have killed over 1,000 public officials, 12 Supreme Court Justices, over two dozen journalists and more than 200 judges and judicial personnel, not to mention the high toll of ordinary citizens who happened to be in the wrong place at the wrong time.

In FY 91, for anti-narcotics programs with our Andean partners, we are requesting $137 million in FMF and approximately $209 million in ESF. Using the model we have found successful elsewhere in the world, we are taking a coalition approach: our Andean partners are the ones who must actually confront the problem in their own countries, and they look to us to provide them with appropriate military and economic assistance. Our military assistance helps them maintain effective mobility and military capabilities. Our economic assistance will assist them in developing legitimate alternatives to the trade in illicit narcotics and in implementing other structural adjustments necessary to sustain economic growth.

Pakistan/Philippines

Our stabilizing influence has helped bring democracy to other regions as well. In Pakistan and the Philippines, we have supported the fundamental shift in recent years to more pluralistic and democratic societies. We have embraced this trend and are helping develop the institutions and policies to make it irreversible. It is not an easy task. Both countries face internal resistance to reform, and both have embarked on painful programs to restructure their economies. We must work to foster the broader political stability that will permit these policies to succeed.This will require substantial military and economic assistance.

The Soviet withdrawal from Afghanistan has not brought peace, and final resolution of the continuing violence there will take a long time. A strong and secure Pakistan, able to play a leading role in this process, will be vital to restoring stability to the region.

Our interest in a free and stable Philippines stems from our historic ties to these islands. Continued U.S. access to military bases in the Philippines promotes regional stability and protects vital Pacific trade routes. Continued political and economic progress in the Philippines itself, however, is threatened by a Communist insurgency dedicated to seizing power through violence. Our military assistance program helps the Philippines meet this threat. U.S. economic assistance is designed to support the democratic government's efforts to meet its people's economic and social needs.

Our security assistance requests for Pakistan and for the Philippines are designed to enhance security and promote reform in these emerging democracies. For Pakistan, we have requested $228 million in FMF and $210 million in ESF. For the Philippines, we have requested $200 million in FMF and $160 million in ESF, in addition to our requests for development assistance, PL-480 food aid, and $200 million in a special assistance initiative.

Middle East

Nowhere is the task of promoting democracy and stability more challenging than the Middle East; and nowhere have our diplomatic efforts been more intense to achieve a negotiated solution to a conflict.

We have constructed a process, aimed at a breakthrough in the decades-old confrontation between Israelis and Palestinians, which could then be broadened to an effort to achieve a lasting peace between Israel and the entire Arab world. Both Egypt and Israel have worked hard with us on a framework for an Israeli-Palestinian dialogue in Cairo to discuss elections in the West Bank and Gaza. We are now working intensively on turning this concept into a practical reality.

The challenge of consolidating the progress we have made is great. We need to remain steadfast in our traditional support as we push our bilateral and multilateral dialogue into new areas. We are again requesting $5.1 billion in military and economic assistance for Israel and Egypt. That amount represents 61% of our total security assistance request. These funds meet military modernization requirements and contribute to economic stability and development objectives.

Conclusion

I ask for your support for full funding for the President's balanced approach to the FY 1991 foreign assistance budget. It is the right response for today, one that carefully nurtures positive change, deals with continuing problems, and strengthens the framework that will ensure stability during this time of transition. Thank you.

Mr. OBEY. Thank you.
Mr. Wolfowitz.

MR. WOLFOWITZ'S OPENING STATEMENT

Mr. WOLFOWITZ. Mr. Chairman, I too am pleased to appear here to discuss these important subjects. I will see if I can emulate my colleague in keeping my remarks short.

Mr. Chairman, my friend and former colleague, Frank Fukuyama, stirred up quite a debate last year with a provocative article entitled "The End of History." His point was not that the historical clock had wound down and stopped, but that the ideas of democratic capitalism had triumphed to such an extent that old-fashioned ideological conflict, indeed most large-scale violence between states, is or will soon be passe.

I suppose the question is whether you measure soon in historical time or in the kind of time we have to work with for policy.

Let me hasten to add that I believe that this millennium has not arrived yet. I do think the analysis is an ingenious way of looking at the changes in the world today, and I agree fundamentally with the long-term optimism about the power of democratic ideals.

But I am also concerned that too much of that kind of reasoning can lead to excessive optimism about the threats to peace and stability in the world. In fact, many people who read that article missed a rather large caveat, about which the article itself is quite clear, that there are many places on earth where history is far from over.

It is in these areas, where conflicts of the past continue unabated, and where new threats as varied as drugs and ballistic missile proliferation foster violence and instability, that our security assistance program has an especially vital role to play.

NEW DEMOCRACIES

Let me focus first, though, on the extraordinary positive changes which we have witnessed in this spectacular past year in the Soviet Union and Eastern Europe, where we saw an extraordinary shift away from Marxism toward democracy and free market economics, a shift which also brought welcome changes in the military sphere as well.

That has been part of a ten-year trend in other parts of the world toward greater democracy. Most recently, in South America, we saw General Pinochet become the latest in a series of authoritarian leaders to hand over power to an elected civilian government.

In Asia, Pakistan, South Korea, the Philippines and Thailand have made similarly large strides. And on the other end of the political spectrum, we applaud the results of the elections in Nicaragua, and hope that the Sandinista government will, indeed, relinquish power in good faith and abandon any hopes of "governing from below."

Mr. Chairman, I submit that our foreign assistance programs, both our economic assistance and our security assistance, have played a role in promoting that positive trend.

The United States' steady and patient promotion of democracy around the world for the last 40 years has helped to bring about some of the progress that we witness today. It would be a tragedy if we were to slacken our efforts now, where in so many places the victory is in sight.

INSTABILITY IN THE DEVELOPING WORLD

Unfortunately, despite the progress in the Soviet Bloc and in many other areas of the globe, we still see continuing instability in much of the developing world. There are several reason for this, but I would underscore that the most important one is that there are many regional, ethnic and national antagonisms for which the Soviets are in no way responsible, and those antagonisms are not moving on the same positive course as East-West relations.

The bulk of our security assistance, in fact, goes to help countries deal with threats and conflicts that are largely or entirely local in origin.

Some of these conflicts are getting worse, not better, and are being exacerbated by the introduction of ballistic missiles, chemical weapons, and potentially even nuclear weapons.

In this period of great but uneven change, our strategy must be to prepare for a spectrum of contingencies that we and our allies and friends may face, so as to preserve and build upon the gains that we have made for freedom and democracy.

Our efforts in this regard are not altruistic. They are in our own national interest, a point that is sometimes lost in the debate over our foreign assistance programs. The United States will always have an interest in economic and political stability throughout the world. A return to isolationism is simply not an option.

U.S. SECURITY ASSISTANCE

As we attempt to manage what we hope will be a transition to a more stable, peaceful world, security assistance plays a number of roles. First and most obviously, it enables friends and allies facing external or internal security threats to defend against those threats with minimum help from us.

It also aids stability by helping our friends feel secure about their ability to defend themselves, a stability that can help to raise the threshold of violence and reduce the risk of war.

Our security assistance program is also a component of our strategy of forward deployment, and as we move away from large-scale forward deployments, as we are doing, to smaller more mobile forces, the bases and access rights that are critical to our ability to project power will become all the more important.

Further, our security assistance programs serve as a kind of military diplomacy, a process that helps to introduce military personnel from other nations to the professionalism and democratic ethos of our own military. Ties like these help promote cooperation between the civil and military sectors of society in countries that may not have such a tradition.

An important new element of our security assistance program is our aid for governments in South America and the Caribbean in their fight against narcotics traffickers. Countries like Colombia face severe military threats from well armed and ruthless drug lords and related insurgencies.

Mr. Chairman, recognizing the budgetary and fiscal realities that limit our abilities to deal with every problem, our total request for fiscal year 1991 is $53.5 million less than last year's request.

Let me add that, in a time of limited resources, it is more important than ever that we have the flexibility to allocate security assistance funds to meet our priority needs. I deeply appreciate this subcommittee's support in the past on the issue of reducing earmarks, and I hope for your continued support in this year's appropriation cycle.

I would just note one important new element of our program where we have increased our request. And that is our counter-drug program. This is an area where relatively small amounts of U.S. aid can provide a big payoff.

We are requesting a total of $137 million for the Andean nations, and another $9 million for countries in the Caribbean, primarily with narcotics problems in mind. This represents a $16 million increase in military assistance funding for these countries over 1990. But we believe that increase is absolutely necessary.

These countries need and deserve our assistance in the joint struggle against narcotics trafficking.

Mr. Chairman, I would like to conclude with two points. First, speaking for the Department of Defense, I would like to emphasize the value that we attach to security assistance. As I am sure you are aware, in just the past 18 months, the Department of Defense has provided over $1 billion out of DOD funds to meet emergency needs for foreign economic assistance in Eastern Europe and Central America in particular. We took the money out of our own budget to ensure that it would not be taken out of the security assistance budget. We have made clear what our priorities are.

And finally, Mr. Chairman, I would just like to conclude on a somewhat more personal note. I share your concern about the importance of economic assistance. I believe, indeed, as I think you said in your opening remarks, that economic assistance can help to eliminate some of the root causes of conflict.

I would say that economic assistance is a complement to security assistance, though, not an alternative. I came recently from spending three years as the U.S. Ambassador in Indonesia. It is the fifth largest country in the world; it is a country that faces enormous economic problems.

That government, including its military, who are probably the most important element in the government, recognize that Indonesia's own security depends, first and foremost, on economic progress.

Indonesia gets enormous amounts of economic assistance, and not only from us. They get billions of dollars from Japan, and many other countries contribute. But we are the only country that contributes any significant military assistance. This is the case for many other recipients of U.S. aid.

And during my time as Ambassador, we struggled to try to keep our rather small security assistance program to Indonesia alive. When I left, it was down to $1 million. And when we finally had to allocate last year what was left after earmarks, we had to zero it out.

Similarly, in East Asia, we have zeroed out Korea over the last few years, a development that I think was justified, in terms of Korea's progress, but nonetheless, a major reduction.

We have been forced, somewhat unwillingly, to cut Thailand by almost 97 percent from where it was earlier in this decade.

The major culprit here, as you are well aware, is the lack of flexibility that is imposed by heavy earmarking. I know this subcommittee has supported a more flexible approach in the past. I would urge you to continue to do so.

I believe that security assistance is not, as I said earlier, in competition with economic assistance; I believe it is the important handmaiden of economic development.

Thank you.

[The prepared statement of Mr. Wolfowitz follows:]

STATEMENT OF PAUL WOLFOWITZ
UNDER SECRETARY OF DEFENSE FOR POLICY
HOUSE APPROPRIATIONS SUBCOMMITTEE ON FOREIGN OPERATIONS

March 15, 1990

Mr. Chairman, it is a pleasure to be here today to testify on security assistance. I look forward to working ~~with you~~ throughout Congressional consideration of the President's budget request. Before I go any further, I would like to compliment you, Mr. Chairman, and Mr. Edwards, and the members of this subcommittee for your commitment to a fresh approach to foreign aid. I noted with interest your discussion with Secretary Baker the other day on the need for a bipartisan approach to the situation in El Salvador. I wholeheartedly agree. Let me add that I would like to see this bipartisan approach extended to all of our programs. There is a lot to be done in the world today, and we need to work together to accomplish our country's objectives.

Mr. Chairman, my friend and former colleague Francis Fukuyama stirred up quite a debate last year with a very provocative article entitled "The End of History." His point was not that the historical clock had wound down and stopped, but that the ideals of democratic capitalism have triumphed around the world, to the extent that old fashioned ideological conflict, indeed most large-scale violence between states, is or will soon be passe.

Let me hasten to say that I do not believe this millenium has arrived yet. I do think this analysis is an ingenious way of looking at the changes in the world today, and I do agree with the long-term optimism about the power of the democratic ideal, but I am also concerned that this reasoning can lead to excessive optimism about the threats to peace and stability in the world.

Many people who read that article missed an important caveat about which the article is quite clear -- there are many places on earth where history is far from over. It is in these areas, where conflicts of the past continue unabated, and where new threats as varied as drugs and ballistic missile proliferation foster violence and instability, that our security assistance program has an especially vital role to play.

To focus first on those changes which have occurred, we have seen in the Soviet Union, and especially in Eastern Europe, an extraordinary shift away from Marxism, and toward democracy and free market economics. Events in the political and economic spheres have brought welcome changes in the military sphere as well. Although the Soviet Union retains and will continue to retain tremendous military capabilities, we see, and we welcome, the prospect of attaining a degree of military stability and security in Europe that seemed impossible in the past.

We have also seen remarkable transitions in other parts of the world. In South America, where General Pinochet just recently was the latest in a series of authoritarian leaders to hand over power to an elected civilian government, we have witnessed over the past ten years an extraordinary peaceful evolution toward democracy. In Asia, Pakistan, South Korea, the Philippines and Thailand have made similarly large strides. At the other end of the political spectrum, we applaud the results of the elections in Nicaragua, and we hope that the Sandinista government will relinquish power in good faith and abandon any hopes of "governing from below."

The United States, and its security assistance programs, have played a role in promoting this trend toward democracy in the developing world. In El Salvador, whose people have defied the intimidation of the FMLN and turned out in great numbers to vote in five free and fair elections, U.S. assistance has provided a security umbrella for that country's transition to democracy. In the Philippines, where the government still faces an anti-democratic Communist insurgency, U.S. aid has been critical in safeguarding the political gains that have been made. Our steady and patient promotion of democracy around the world for the last 40 years has helped to bring great progress. It would be a tragedy if we were to slacken our efforts now when, in so many places, victory is in sight.

Continuing Challenges - Ongoing Soviet Role, Indigenous Instability

Unfortunately, despite the progress in the Soviet Bloc and in other areas of the globe, we see continuing instability and conflict in much of the developing world. There are several reasons for this. First, while the Soviets have taken the significant step of withdrawing troops from Afghanistan, and have encouraged the withdrawal of Cuban and Vietnamese troops from countries they moved into in the 1970s, they still provide enormous levels of military assistance and advanced weaponry to countries like Cuba, Libya, North Korea and Afghanistan. In Afghanistan, which is sometimes portrayed as the centerpiece of "new thinking" in Soviet security policy, Moscow is providing some $300 million a month in primarily military assistance, including sophisticated weapons such as Scud missiles. While there has been some progress in resolving conflicts in such trouble spots as Afghanistan, Angola, Cambodia, the Middle East and, most recently and encouragingly, Central America, that progress is still far from complete.

Second, and much more important, there are many regional, ethnic and national antagonisms around the world for which the Soviets are not responsible, and those antagonisms are not moving on the same positive course as East-West relations. The bulk of our security assistance, in fact, goes to help countries deal with threats and conflicts that are largely or entirely local in origin. Some of these conflicts are getting worse, not better, and are being exacerbated by the introduction of ballistic missiles, chemical weapons and, potentially, even nuclear weapons. In fact, this superimposition of increasingly sophisticated weapons technology upon intransigent regional rivalries is one of the greatest diplomatic and military problems we face.

In this period of great -- but uneven -- change in the world, our strategy must be to prepare for the spectrum of contingencies which we and our allies and friends may face, in order to preserve, and build upon, the gains which we have made for freedom and democracy. These contingencies range from the threat of all-out war in some regions, to the lingering low-intensity conflicts we find in many areas of the globe.

Our efforts in this regard are not altruistic, they are in our own national interest. This point is sometimes lost in the debate over our foreign assistance programs. The United States will always have an interest in economic and political stability throughout the world. A return to isolationism is simply not an option.

Role of Security Assistance

As we attempt to manage what we hope will be a transition to a more stable, peaceful world, security assistance plays a number of roles. First and most obvious, it enables friends and allies facing external or internal security threats to defend against those threats. It is far better for us, and for the world, if we can help our friends and allies to defend themselves, rather than use American forces. This is especially important at a time when our military budget is decreasing.

It also aids stability, by helping our friends feel secure about their ability to defend themselves, which can raise the threshold of violence and reduce the risk of hostilities. The stabilizing role of security assistance is especially important in those regions where one country's acquisition of sophisticated weaponry threatens to shift the military balance -- and tempt other countries in the region to follow suit. Security assistance can provide these countries with other, less destabilizing, ways in which to redress the balance.

Our security assistance program is also a component of our strategy of forward deployment. Threats to U.S. interests remain, and the network of bases and access rights we have built up in the post-war era to protect our strategic interests must be maintained. Even if, just for the sake of argument, the Soviet Union never again posed a military threat to U.S. interests, we would still need the ability to project military force. As we move away from large-scale forward deployment to smaller, more mobile forces, the bases and access rights that are critical to our ability to project power will become all the more important.

Our security assistance programs also serve as a kind of military diplomacy -- a process which introduces military personnel from other nations to the professionalism and democratic ethos of our own military. Ties like these help promote cooperation between the civil and military sectors of society in countries which may not have such a tradition. In many of these countries the military is an important institution, a major source of technical and engineering skills, which plays a critical role in the overall development process. Security assistance is essential to maintain ties and influence.

An important new element of our security assistance program is our aid for governments in South America and the Caribbean in their fight against narcotics traffickers. Countries like Colombia face severe military threats from well-armed and ruthless drug lords, and related insurgencies.

Finally, we must remember that our military sales to friends and allies, which as you know are conducted under careful regulation and Congressional oversight, contribute strongly to our export base. As domestic defense procurement diminishes, foreign sales become more important in maintaining reasonable unit costs, sustaining production lines and preserving jobs in key high-technology industries - all important contributions to our abilities to mobilize if that need should arise again. As you know, almost all our security assistance funds are spent here at home and, together with sales, contribute directly to the domestic economy. Also, declining defense budgets and smaller production runs will raise the relative importance of foreign military sales--already five percent of total U.S. exports. In an era where international trade will become ever more important for U.S. industry, we cannot afford to ignore the part played by the defense industrial base in our high-technology trade.

FY 91 Security Assistance Request

With these considerations in mind, I turn to our request for security assistance in 1991. Recognizing the budgetary and fiscal realities that limit our abilities to deal with every problem, our total request for FY 1991 is $5,016.9 million--$53.5 million less than last year's request. Let me add that, in a time of limited resources, it is more important than ever that we have the flexibility to allocate security assistance funding to meet our priority needs. I appreciate the subcommittee's support in the past on the issue of reducing earmarks, and I would ask your continued support in this year's appropriations cycle.

Let me begin the programmatic details with our counter-drug program. This is an area where relatively small amounts of U.S. aid can provide a big payoff in increased capabilities. We are requesting a total of $137 million for the Andean nations, and another $9 million for countries in the Caribbean, with narcotics, and in some cases, related insurgency problems. This total request of $146 million represents a $16 million increase in military assistance funding for these countries over FY 1990. Our request is the security assistance component of a multi-agency anti-narcotics initiative, to which we in the Defense Department plan to devote $2 billion in fiscal 1990 and 1991.

We believe that increased funding is absolutely necessary for a number of reasons. Thanks to the courage and resolve of the Barco government, Colombia has begun to turn the tide against the cocaine cartels. The proposed $58 million will provide much-needed helicopters, spare parts, vehicles, weapons, ammunition and other vital supplies to the Colombian armed forces. We propose $39 million for Peru, which faces a similar situation and a determined Maoist insurgency as well. We are requesting $40 million as well for Bolivia, another Andean nation with extremely limited resources. FY 1990 budget constraints and earmarking did not permit us to fund other states with severe narcotics problems such as Ecuador, or some of the island nations of the Eastern Caribbean. These countries need and deserve our assistance in the joint struggle against the narcotics traffic.

Before I get into some of our other important programs, let me make two points. One, you have expressed your concern, Mr. Chairman, that despite all the changes that have occurred in the world, this year's request looks just like last year's. I believe that we have sound programmatic reasons for our specific country allocation requests. The U.S. government has substantial on-going and soon-to-be-started contracts and modernization programs with a number of important allies, including Turkey, Portugal and Pakistan, as well as Israel and Egypt. Some of these programs continue into the mid-1990s. Ongoing modernization programs and the sustainment of existing equipment are critical, and cannot easily be reversed at a moment's notice.

Secondly, these are, for the most part, minimal programs for minimal conventional deterrence That is, they provide the recipients with the means to deter against a variety of, though by no means all, possible threats to their stability and sovereignty. As I previously mentioned, the 1990s could well see more, not less, regional instability. As we reduce the size of our armed forces and cut back on overseas deployments, we will be, in effect, relying more on our friends' ability to defend themselves. Now is not the time to degrade that ability

Turkey

We are asking $545 million for Turkey. Turkey borders on the Soviet Union, Syria, Iran and Iraq and thus faces potential threats of a different order than our other NATO allies. Unlike most other NATO nations, who benefit from the reduction in the Warsaw Pact threat, Turkey remains exposed directly to Soviet military force, and borders on an extremely unstable area of the USSR. While the threat of a deliberate Soviet assault on this critically located NATO ally has decreased, the internal nationalist and ethnic strife in the southern Soviet Union poses the threat of additional regional instability and complications with other powers in the area. The Soviets continue to supply military equipment to many of these nations. Turkey also provides bases and facilities for communications and intelligence that will continue to be critical to U.S. security interests in maintaining the stability we have achieved to date. We have never been able to provide Turkey with what that country really needs its defense, and much of their equipment remains a generation behind that of almost all other NATO allies. For these reasons, it is important to sustain and increase our level of assistance. Our request is an increase of $45 million dollars over FY 1990.

Pakistan

We are requesting $228 million for Pakistan. As you are well aware, support to the Afghan resistance would not have been possible without the help of Pakistan. However, conflict in Afghanistan has not ceased with the Soviet withdrawal. The Soviets continue to pump massive quantities of arms to the Najibullah regime. Our assistance program will help Pakistani modernization as well as provide a tangible demonstration of support to Benazir Bhutto's government as it continues the difficult democratization process following years of authoritarian rule. Pakistan as you know is at the center of a strategically important region, where tensions remain high. Our continued assistance contributes to Pakistan's sense of security, contributing to their ability to take risks for peace and lessening the likelihood that they might acquire nuclear weapons.

Philippines

This year, as last year, we are requesting $200 million for the Philippines. As you know, the U.S. government pledged best efforts to obtain $400 million over a two-year period in military assistance as part of negotiations on our base rights in the Philippines. As a result of earmarking and funding reductions we were only able to allocate $140 million. These funds are critically necessary to purchase support, training, maintenance and new equipment in order to combat the anti-democratic insurgency. It is important to the success of President Aquino and Philippine democracy, as well as the future of military facilities in the Philippines beyond 1991, that our "best efforts" pledges not be vitiated.

Portugal

Portugal, like Turkey, is another firm ally to whom we have prior commitments to support modernization. The Portuguese have been very cooperative in the past in allowing the U.S. to use the Lajes air base in the Azores for transit to the Middle East and Southwest Asia -- areas that have not been notably affected by the reduction of tensions in Europe, and where instability and the threat of armed conflict remain high. These facilities are also important to our anti-submarine and sea control operations, and are a critical staging point for resupplying forces in Europe. The flexibility these facilities give us becomes even more important if forces overseas are cut.

As with the Philippines, we were forced to come up short in 1990 on best-efforts pledges made to the Government of Portugal as part of base-rights renegotiations. It is important that we not do this two years running, or we risk seriously undermining our position in the negotiations for a new agreement. Portugal is the second-poorest NATO nation after Turkey, and the $125 million we have requested is needed to support pressing needs to establish modern Portuguese air defense, anti-submarine warfare, mobility, communications, combat support, anti-armor and program management capabilities.

El Salvador

In El Salvador, we are seeking $90 million to provide equipment and training to assist the Salvadoran Armed Forces (ESAF) to combat the FMLN insurgency. This radical Marxist organization still seeks the violent overthrow of the democratically-elected Cristiani government. As I noted earlier, in November of last year, the FMLN began a major offensive, fighting in heavily populated communities in major cities and often, cruelly and cynically, using civilians as a shield. The ESAF successfully repulsed the FMLN assault, making great efforts to avoid harm to civilians. While the U.S. continues to support a peaceful solution, and while the recent election in Nicaragua may facilitate such a result, it would be a mistake to reduce our support at a time when the threat is so far undiminished, and when a withdrawal of U.S. support would provide a boost to the extremists of the right and the left.

Jordan

The moderate Arab state of Jordan plays a vital role in the search for Middle East peace. However, after several years of insufficient assistance the Jordanians have been forced to reduce their capability and readiness just to keep U.S.-origin equipment operating. It is important to maintain this critical relationship by financing limited quantities of urgently-needed support. The proposed $50 million will meet minimal sustainment requirements for the Jordanian Armed forces, a bedrock of support for King Hussein.

IMET, Other Programs

We are also requesting funding to restore other small, but nevertheless valuable programs in Latin America, Africa and Asia that had to be zeroed out of FY 1990 funding. Such small programs bear fruit far out of proportion to the dollar amount spent in terms of good will, contacts and influence.

We propose $50.5 million for the International Military Education and Training program (IMET), four million less than last year's request. IMET has been widely recognized as our most cost effective foreign assistance program. IMET is a people program that establishes valuable personal relationships and communication with foreign military personnel, many of whom rise to prominent positions within their countries. As I noted earlier, IMET students return to their countries with new understanding of our military ethos of professionalism and respect for civilian authority. Many retain a respect and admiration for the U.S. which, though difficult to quantify, often proves invaluable in future relations with these countries. This program has been criticized because some of the participating countries are small, poor and face minimal military threat. But I believe this criticism misses some of the essential goals of the program.

Furthermore, in many of these countries, where the military may be the only functioning modern institution, IMET provides technical training and an education in military professionalism that help graduates play significant roles in nation-building. Finally, these countries represent less than 20% of the students and total annual IMET appropriations.

Conclusion

Mr. Chairman, I believe that in these times of historic change, we have a responsibility to preserve all that we have worked for over the years -- the stability, democracy, and prosperity which have made great strides under the umbrella of U.S. security assistance. This program remains a vital part of U.S. national security policy, and will continue to play a role in promoting these goals in an uncertain and still dangerous world.

I would emphasize once more the great importance which the Department of Defense places on security assistance. As I am sure you are aware, in the past year and a half, the Defense Department has provided over a billion dollars out of DoD funds to meet emergency needs for foreign economic assistance, most recently as part of the current aid package for Panama and Nicaragua. We took the money out of our own hide, to ensure that it would not be taken out of the security assistance budget. We have made clear what our priorities are.

I recognize that fiscal constraints limit our abilities to fund all these pressing needs today. We do not ask for increases over our previous request, but we do ask for flexibility. With that flexibility, the proposed budget represents adequate levels for Security Assistance in 1991. I urge you to support it. Thank you.

Mr. OBEY. Thank you.
Mr. Edelman.

MR. EDELMAN'S OPENING STATEMENT

Mr. EDELMAN. Thank you, Mr. Chairman.

I am especially pleased to come before you today to discuss the opportunities to promote political stability, democracy, and economic freedom throughout the world.

The ways in which increasing numbers of nations address these issues, and our efforts to support them, is one of the central and most exciting challenges we face at A.I.D.

Our world is a dramatically different place today than it was 50 years ago, or even a decade ago or, most remarkably, even last week. The democratic revolutions in Eastern Europe and Central America require support to achieve political and economic stability. We seek a modestly expanded assistance program to buttress the promise that democratic freedoms and economic opportunity can and do sustain one another.

Economic growth depends on the existence and health of democratic institutions. At the same time, the stability of democratic institutions depends a great deal on economic growth and opportunity.

Moreover, unless there is a sharing of economic power, true political pluralism is unlikely to emerge.

The explanation for this phenomenon is really quite simple. Democracies encourage competition and provide a process of self-correction through accountability, making pluralistic societies better able to avoid economic rigidity and, in turn, providing opportunities to effectively improve standards of living.

Creating and sustaining the democratic institutions necessary to guarantee individual freedoms and enhance opportunities to promote economic growth is a central task before nascent democracies and before A.I.D.

A.I.D.'S OBJECTIVES

Nurturing democratic institutions and fostering political pluralism is implicit in the three policy objectives which guide A.I.D's programs:

First, support for economic growth that is sustainable in both economic and environmental terms.

Second, emphasis on the development of human capacity.

And third, pluralism, particularly the promotion of democracy, freedom and competition in the political, economic and social institutions of a nation.

A.I.D.'s strategy for achieving these goals is multi-pronged and mutually reinforcing. To promote growth, our assistance emphasizes the role of private, competitive market forces in the allocation of resources.

To promote human capacity development, we emphasize training as well as strengthening institutions, seeking to improve basic education and health.

And to promote pluralism, we emphasize strengthening democratic institutions, a fair and independent rule of law, and opportunities to enhance civil and political rights.

These objectives are encompassed in our overall goal, which has never changed: the promotion of economic development which fosters human dignity, and foreign policies which encourage human freedom.

Further, the interplay of A.I.D.'s objectives are mutually reinforcing. Thus, while many of our initiatives specifically undergird democratic development, strengthening pluralistic societies is inherent in most of our ongoing programs.

For instance, in developing societies, A.I.D. attempts to strengthen those institutions which promote the openness and transparency of markets, the fair and efficient adjudication of disputes, and the rights of individuals to associate for economic purposes, to hold property, and to retain the profits from their labor.

We are directly supporting democratic institutions, thereby encouraging pluralistic societies, particularly at the local grassroots level.

It is at this level where democracy's foundation can most clearly be witnessed through the direct interplay of non-governmental organizations, interests groups, cooperatives, labor unions, and other local organizations.

Specifically, our private sector development activities facilitate broader access to credit, nurture small-scale enterprises, and foster the diffusion of power.

These sorts of activities serve to decentralize economic power, strengthen diverse interest groups, and ultimately stimulate pressures for democratization.

Cooperatives promote volunteerism, democratic choice, and the economic effectiveness of private enterprise. Cooperatives, credit unions and other local organizations prove an effective means by which people can express their views, choose their leaders, and lobby for needed resources.

This is democracy at its core.

Trade unions are another example of democratic societies.

A.I.D. also continues to encourage programs that promote increased adherence to civil, political and human rights. Voter education and civic education programs are strengthening electoral processes and democratic institutions throughout the developing world.

A.I.D. has been working with host governments and PVOs to build democratic institutions for more than a decade.

For instance, in Indonesia, from where Ambassador Wolfowitz has just returned, our approaches encompass activities such as leadership development, election assistance, promotion of press freedom, improved justice administration, legislative training, and start-up seed grants to small organizations.

In Eastern Europe, we are undertaking democracy-building programs aimed at strengthening civic education, legislatures, political parties, labor unions, and electoral systems.

Our challenge is to engage in development whereby democratic institutions emerge from a society where power is widely diffused, and broad-based economic development is sustainable.

Our challenge as Americans is to ensure that the democratic values and principles we hold dear remain a cornerstone of our development, and that the vigorous development process which we support enhances the individual freedom and peaceful cooperation among peoples.

Finally, Mr. Chairman, on a personal note, one week from today the new Administrator of A.I.D., Dr. Ronald Roskens takes over the helm, at which point I will revert back to being Avis, and he takes over as Hertz of A.I.D.

The past nine months, I think, have been the most exciting in my life. There is no better time to be trying to run a development agency than when democracy is sweeping throughout the world, which everyone in this building and in this town support.

For that, I would just like to extend a public thanks to my good friend Alan Woods and to President Bush for giving me this opportunity. And I assure you that, although I will not be Hertz after next week, I will continue to try harder to work together with you and this committee to advance these really exciting goals.

Thank you.

[The prepared statement of Mr. Edelman follows:]

STATEMENT OF MARK L. EDELMAN
ACTING ADMINISTRATOR
AGENCY FOR INTERNATIONAL DEVELOPMENT
BEFORE THE
HOUSE APPROPRIATIONS SUBCOMMITTEE
ON FOREIGN OPERATIONS
MARCH 15, 1990

I. INTRODUCTION

Mr. Chairman, members of the Subcommittee, it is a privilege to come before you and discuss opportunities to promote political stability, democracy and economic freedom. The ways in which increasing numbers of nations address these issues -- and our efforts to undergird them -- is today a central challenge facing A.I.D. I appreciate the opportunity you have given me to review our approach, and how we can -- with Congress' help -- build on that record.

Though recent events have presented us with new opportunities and challenges, the basic tenets of our philosophy remain unchanged since the announcement of the Marshall Plan. As General Marshall himself said in 1947:

> "Our policy is directed not against any country or doctrine but against hunger, poverty, desperation and chaos. Its purpose should be the revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist."

Today our world is a dramatically different place than it was fifty years ago, or even a decade ago. In large part these differences were brought about not only by the evidence of failed centrally-controlled economies, but also by millions of citizens -- from every region of the world -- peacefully confronting governments which denied them the freedom to choose their own economic and political destinies.

Born out of the ashes of failed statist economies -- and amidst great hopes -- we now stand at the precipice of a new decade... and a new era. A new era born with the insecurities of change, it also holds great promise for the things we know to be fundamentally true: that democratic freedoms and economic opportunity sustain one another.

II. ECONOMIC GROWTH AND POLITICAL PLURALISM

Economic growth depends on -- among other things -- the existence and health of democratic institutions in a democratic setting, while, at the same time, the stability of democratic institutions depends a great deal on sustained economic growth and opportunity.

Democratic government essentially brokers the interests of disparate groups and the making of political consensus -- and has the best chance of assuring that economic opportunity is equitable for all. Moreover, unless there is a sharing of economic power, true political pluralism is unlikely to emerge. Unless a society enjoys long-term, broad-based economic growth, its people will have little chance of securing or maintaining a political order that insures pluralism, individual freedom, or opportunities for individual development.

With their more flexible economies, democracies have continued to demonstrate the efficiency and dynamism necessary to maintain strength in a complex and difficult international economic environment. We have seen time and time again that the internal pluralistic systems of democracies are most effective in stimulating and sustaining economic growth. Because they encourage competition and provide a process of self-correction through accountability, democratic societies are better able to avoid rigidities in economic matters. This in turn affords democratic societies the opportunity to effectively provide their citizens with improved standards of living.

Creating and sustaining the democratic institutions necessary to guarantee individual freedoms is a central task before nascent democracies -- and before A.I.D. The recent expansion of political freedom in Africa and Latin America as well as in Eastern Europe creates demands as well as opportunities for economic freedom. Thus, integral to the success of any society is political, social and economic pluralism, based upon a rule of law which provides equal protection for all.

III. A.I.D.'S OBJECTIVES

As we face the 1990's with a renewed conviction in the veracity of this linkage, A.I.D. has set forth the following three objectives for our bilateral assistance program:

- Economic growth that is broad-based and sustainable, in both economic and environmental terms;
- Human capacity development, with particular emphasis on achieving health and education levels sufficient to enable all citizens to contribute to and benefit from economic progress; and,
- Pluralism, particularly the promotion of democracy, freedom and competition in the political, economic and social institutions of a nation.

These pursuits are encompassed in our overall goal which has never changed: the promotion of economic development which fosters human dignity, and foreign policies which encourage human freedom. This is often best achieved by seeking development of institutions which unleash the creative energies and human resources that abound. We believe freedom -- economic and political -- is the most efficient organizer of these resources. It is the free market that unleashes human energies and serves as the best engine for economic growth and development. Private enterprises that respond to a free market produce jobs, skills and hence, economic growth, thereby contributing wealth to society and improving the quality of life.

IV. A.I.D.'S STRATEGY

A.I.D.'s strategy for achieving objectives for growth, pluralism and human capacity development is multi-pronged and mutually reinforcing. To promote growth, our assistance emphasizes the role of private, competitive market forces in the allocation of resources. This involves, for example, projects in Africa, Asia and the Near East that support the free market determination of prices paid to farmers, as well as the allocation of credit and foreign exchange to activities that are commercially viable and environmentally sustainable.

To promote human capacity development, we emphasize training to fill the technical and managerial gaps that constrain economic performance. With the same objective, we emphasize the improvement of the ability of host country institutions to provide basic education and health required to enable all citizens to contribute to and benefit from economic progress.

To promote pluralism, we emphasize strengthening democratic institutions, a fair and independent rule of law, and opportunities to strengthen civil and political rights.

The synergism among these three strategic elements is important. All of the evidence, for example, indicates that denying protection for property and human rights reduces the level of private investment, thus reducing growth prospects. Similarly, policies that promote democratic institutions reinforce policies to promote the role of private, competitive market forces. A.I.D. attempts to strengthen those institutions which promote the openness and transparency of markets, fair and efficient adjudication of disputes, and the promotion of the rights of individuals to associate for economic purposes, to hold property and to retain the profits from their labor.

The interplay of A.I.D.'s objectives can have mutually reinforcing results. Thus, while many of A.I.D.'s initiatives specifically undergird democratic development, a great many of A.I.D.'s ongoing programs not only support but also benefit from pluralism initiatives. This is particularly true at the local, grassroots level throughout the developing world. It is at this level where democracy's foundation can most clearly be witnessed -- through the direct interplay of interest groups, cooperatives, labor unions and other local organizations.

Private sector development -- always a critical element in energizing economic growth -- does so by facilitating broader access to credit, nurturing small scale enterprise and an emerging middle class, and fostering the diffusion of power. Through A.I.D.'s private sector initiatives, a strong indigenous private sector and the channelling of an increased share of A.I.D. resources to that private sector is encouraged. This further serves the purpose of decentralizing economic power, strengthening diverse interest groups, and thus stimulating pressures for democratization. In our private sector approaches to development, we are seeking to turn every individual into an "engine of growth".

Our relationship with PVOs serves to strengthen pluralism by drawing together the public and private sectors. PVOs and other institutions -- such as universities, research institutions, schools, and civic associations -- bring the vigor of the private sector into play. PVOs provide direct channels for private initiatives which broaden the participation of individuals in the decisions which affect their economic and social status.

A.I.D. further encourages development of pluralistic societies by supporting cooperatives. These voluntary, independent business enterprises, as well as credit unions and other such local organizations prove an effective means by which people can express their views, choose their leaders, and lobby for needed resources. This is democracy at its core. Free trade unions, too, have proven to be strong supporters of democracy which they regard as necessary for their existence.

Finally, A.I.D. continues to encourage programs that promote increased adherence to civil, political and human rights. This approach recognizes that in the long-term, democracies are the best guarantor that civil and political rights may endure.

Always tailored to country-specific needs, A.I.D. works with host governments and PVOs to build democratic institutions. For instance, in Bangladesh we are providing assistance such as leadership development, election assistance, promotion of press freedom, improved justice administration and legislative training. In Eastern Europe, we are undertaking a broad program attempting to strengthen the areas of civic education, legislatures, political parties and electoral systems.

None of these activities matter without support for the rule of law. A strong, responsible, but independent judiciary is a cornerstone of democracy and development. Economic development generally is dependent upon a consistent judiciary that provides for predictability and enforcement of contracts and laws, thereby reducing economic risk.

By fostering this broad "infrastructure of democracy", A.I.D. supports a detailed system of individual rights, such as the right to choose, participate and associate. A.I.D. attempts to strengthen this infrastructure not only through our mainstream programs, but also by supporting opportunities to build institutional capacity and increase citizen awareness of and participation in the political process.

V. A.I.D.'S FINANCIAL REQUIREMENTS

Nurturing democratic institutions and fostering political pluralism is implicit in the three policy objectives upon which A.I.D. is grounded: economic growth that is broad-based and sustainable, in both economic and environmental terms; human capacity development, with particular emphasis on achieving health and education levels sufficient to enable all citizens to contribute to and benefit from economic progress; and, pluralism, particularly the promotion of democracy, freedom and competition in the political, economic and social institutions of a nation.

Though our objectives have not changed, global dynamics never cease. And ours is a global development program. The democratic revolutions contorting the staid order of Eastern Europe, as well as those in Latin America, require economic assistance to sustain their new political foundations. This in turn may contribute to enhanced political stability. We seek to contribute not only to Eastern Europe and Latin America, but to balance these investments against those of struggling nations elsewhere who have known neither freedom nor development.

As the speed of events in Eastern Europe and Latin America so dramatically illustrates, the opportunity for flexible responses are necessary now more than ever, in order that we may respond quickly and effectively to the changing world environment. I am reminded of the prescience of my good friend the late Alan Woods, when he predicted last year that "Radically reshaping future official assistance programs to face new realities ...to global development must be both an immediate concern and a major long-term commitment".

For example, we are increasingly able to embrace opportunities in Africa, where through the Development Fund for Africa (DFA), resources are allocated to respond efficiently to priority development problems on a country-specific basis. The FY 1991 DA request includes $560 million for the DFA. While proposed assistance will benefit over 40 countries in Africa, more than half of the bilateral DFA request will be targetted to 10 major high-performing countries. Since its establishment by Congress in FY 1988, the DFA has allowed A.I.D. to shape its programs in Africa to respond quickly to economic and social changes. We believe this model has succeeded and the lessons learned should be replicated beyond Africa.

Specifically, the DFA has permitted us to more fully engage the Senegalese in banking reform -- which of course has regional implications. This in turn enables larger numbers of Senegalese to establish credit, build savings and engage more fully in their economic society. The DFA has further proven itself an effective, flexible tool of development by: providing larger amounts of health care for Kenya and Nigeria than would have been possible under functional accounts, and increasing export processing zones in Togo and Cameroon.

There are other creative responses we are undertaking which merit mention. To bolster and reinforce opportunities for economic freedom, for FY 1991 A.I.D. has requested a special financial account called the Development Policy Reform Program (the DPRP). We have set aside $75 million in our DA request for the DPRP to allocate to those countries which are demonstrating a firm commitment to undertake the economic policy reforms necessary to ensure steady and sustainable economic growth. These funds will go to a small number of countries each year for innovative proposals. Eligibility to compete will be based on objective measures of which countries have demonstrated the greatest progress in policy reforms which promote economic freedom.

Further, a new A.I.D. account, Special Assistance Initiatives, began last year with the Multilateral Assistance Initiatives for the Philippines. This year funds for Eastern Europe are also requested under this account. This account is designed to target economic assistance on rapidly evolving political and economic reforms in recipient countries. Our FY 1991 request for the SAI totals $200 million for the Philippines and $300 million for Eastern Europe.

A critical element of A.I.D.'s assistance program is its field-oriented approach, unique among donors, which involves more than 60 field missions in recipient countries as well as a support staff based in Washington. The Agency's country expertise makes possible the development and implementation of activities appropriate to the situation of each recipient. This management approach is carried out by a world-wide staff and supporting contractors financed by the Operating Expenses account, for which $447.8 million is requested in FY 1991, plus $33.8 million for our Inspector General.

A.I.D. is meeting the challenge of a changing world order, and contributing to the economic dynamism which is sweeping the globe. Our FY 1991 bilateral economic assistance program request totals $6.2 billion. This request includes funding for Development Assistance, the Economic Support Fund and the Special Assistance Initiatives program. Of this, the FY 1991 request for bilateral Development Assistance is $2.4 billion.

VI. CONCLUSION

Our policies are based upon the recognition that only in democracies is there inherent respect for individual liberties and rights. Only in democracies is there freedom of expression and genuine participation in choosing leaders. For the existence of these freedoms determines whether a people will govern themselves, or be governed.

Maintaining and nurturing democracy is never easy. Yet if it can be said that the annals of history chronicle the pilgrimage of freedom, then perhaps the future will grace all mankind with enhanced opportunities. We hope our approaches continue to flourish and take on even greater dimensions as we move, in tandem with freedom-loving peoples everywhere, toward the next century.

Our challenge at A.I.D. is to engage in development whereby democratic institutions emerge from a society where power is widely diffused, and broad-based economic development is sustainable.

Our challenge as Americans is to ensure that the democratic values and principles we hold dear remain a cornerstone of our foreign policy, in our vigorous determination that all peoples' lives be enhanced by freedom, peaceful cooperation, and economic development.

That concludes my formal testimony, Mr. Chairman. I will be happy to address questions from you and your colleagues.

Mr. OBEY. Thank you very much.

Mr. Mulford, before you begin, I simply want to say, in line with the conversation we had with Secretary Brady yesterday, I have some doubts about the specific action you took with respect to zero-coupon bonds. But I thought that the tone of the Wall Street Journal editorial concerning you was absolutely outrageous.

I think you are a first-rate public servant. And if we had the kind of balanced thought out of the editorial pages of the Journal that we usually get from you, I think the country would be in much better shape.

MR. MULFORD'S OPENING STATEMENT

Mr. MULFORD. I thank you very much for those comments, Mr. Chairman. I appreciate it very much.

I welcome this opportunity to discuss U.S. international economic policy this morning. And in summarizing my statement, I would like to begin with some rather general thoughts first.

I would contend that U.S. economic, political and security objectives have become increasingly interdependent, and that economic issues will command an increasingly central role in U.S. international relations in the decade ahead.

Why is this so?

First, economic performance is one of the leading issues dominating domestic and international politics around the globe. Economic conditions have recently proven to be the critical determinant of political change in the Soviet Union and in Eastern Europe.

In developing nations, efforts to achieve economic growth have encouraged both long overdue adjustment and more open political systems.

Economic interests are helping to drive Europe towards greater unity.

Japan's economic strength and global economic interests are also bringing pressures to bear for change in Japanese domestic policies.

Secondly, we now live in an interdependent multi-polar world, where no single nation can control international events. The advent of sophisticated communications and integrated financial and information markets, the diffusion of economic and political power, and a vastly more prosperous world have made international cooperation a necessity of modern political life.

And third, Mr. Chairman, the relative decline in military and security concerns has highlighted more clearly the strong mutuality of economic interests.

In such a world, U.S. domestic and international economic policies and support for democratic governments now play the critical role in advancing our strategic interests. Recent events in Eastern Europe, as well as in Panama and Nicaragua, underscore this shift.

As we proceed into the next decade, we face the challenge of advancing U.S. interests in an increasingly integrated and interdependent world economy. To do so, the United States must accept that the success of its foreign and economic policies in the post-war era have produced strong European and Japanese economies, and a diffusion of economic and political power that now constrain our own relative power and influence in the world.

We must find a way to execute leadership within the larger, more prosperous, more competitive, and more democratic world we have helped to create. Efforts to restore a more productive, competitive and balanced United States economy are the first step.

Our fundamental objectives today are to promote freedom and democracy, world economic growth with low inflation, more market-based economies around the world, and an open trading system.

INTERNATIONAL ECONOMIC COOPERATION

One of our major means of pursuing these objectives is the Group of seven economic policy coordination process. This process has been successful in continuing sustained world growth, maintaining generally lower inflation, reducing external imbalances, and achieving greater stability in exchange markets.

The coordination process has provided a forum for policy-makers to consider the international implications of their domestic policies, as well as the effects of international developments on domestic economic conditions.

It has also encouraged concrete actions to improve the functioning of the world economy and monetary system. As we look to the future, economic policy coordination will remain essential to meeting global economic challenges, and, in particular, in helping the major industrial countries to adopt the concrete steps necessary for sustaining expansion and reducing external imbalances.

As we seek to work with our allies to advance global growth and stability, we also face challenges in our relationships with them. I am referring in particular to the challenge of learning more effectively in this world.

We have established with the Japanese the structural impediments initiative process to identify and remove structural impediments to adjusting payments imbalances between our two nations.

We are also taking further steps to build on the yen/dollar framework that we have created in the last six years in order to transform Japan's financial system so that it is more truly market-based and so that access by foreign firms is improved.

The United States is also working closely with Europe as it seeks to integrate and to create a monetary union. We have striven to ensure that as that process goes forward, it results in an open and growing Europe.

The newly industrialized economies, the so-called NIES, are also emerging today as key players in the world trading system. And we are seeking, through bilateral discussions with these countries, to ensure that their exchange rates are market-determined, and that their financial markets are open and liberal.

The shift in the global military and political balance and the increasing importance of economic well being to people around the world suggest that long-term stability, as well as democratic liberalization and expansion of free markets, is best advanced by unlocking the economic potential of free markets.

This must be one of our guiding principles in seeking to assess our relations with both developing nations and the new democracies in Eastern Europe in the period ahead.

The IMF and the World Bank, of course, have vital roles to play in assisting developing countries to adopt sound economic policies and in catalyzing international financial support for those efforts.

Their efforts stand at the heart of the international debt strategy, which is producing significant results in addressing individual country debt burdens, notably so far, Mexico, the Philippines, and Costa Rica.

But the international financial institutions are also key for Eastern European countries.

The creation of a sound European Bank for Reconstruction and Development—one that promotes the transition away from command economies towards private markets in Eastern Europe can, in our opinion, provide important additional support.

Bilateral assistance also remains a critical tool for supplementing the development work of the international financial institutions and providing balance-of-payment support. Our bilateral economic assistance allows us to target countries and regions of particular interest to the United States. Putting these resources to efficient use and fostering long-term sustainable economic growth and development will, of course, depend on clear linkages to sound economic policies.

Although recent developments have created an impression that bilateral aid flows would shift sharply to Eastern Europe, I would like to note in this context that we believe bilateral aid will in fact play a secondary role to our efforts in encouraging trade, investment, and private sector developments in these countries.

In Central America, we currently are moving forward with the specific policy steps to support critical political transitions. Response to events in this region in a timely way is essential. In particular, the Administration needs your support on the reallocation of funds to support Panama and Nicaragua.

In short, Mr. Chairman, and in conclusion, economics are increasingly dominating world affairs. To advance U.S. interests successfully in this evolving and increasingly interdependent world, we must assert strong leadership in the context of international cooperation.

The Administration is working hard to meet this challenge. We hope we can count on congressional support and cooperation in this effort.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Mulford follows:]

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Statement of the Honorable
David C. Mulford
Under Secretary of the Treasury for International Affairs
before the Subcommittee on
Foreign Operations, Export Financing, and Related Programs
of the
Committee on Appropriations
U.S. House of Representatives

Mr. Chairman and Members of the Subcommittee:

I welcome this opportunity to discuss U.S. international economic policy in the context of our global political and security interests. I would contend that U.S. economic, political, and security objectives have become increasingly interdependent and that economic issues will command an increasingly central role in U.S. international relations in the decade ahead.

Why is this so? First, economic performance is one of the leading issues dominating domestic and international politics around the globe. This can be seen at election time in any Western democracy and also recently with particular clarity in the Soviet Union and Eastern Europe. In the latter case, economic conditions have recently proven to be the critical determinant of political change.

The impact of economic concerns is also evident in other parts of the world. Developing nations are moving away from the statist economic policies of the past as efforts to achieve economic growth have encouraged both long-overdue adjustment and more open political systems. Economic interests are a leading force in driving Europe toward greater unity. Japan's economic strength has established for that nation a position of commanding global influence and, I hope also, responsibility. Japan's global economic interests are also bringing pressures for change in Japanese domestic policies.

Second, we now live in an interdependent, multipolar world, where no single nation can control international events. The advent of sophisticated communications and integrated financial and information markets has meant that developments in one quarter of the globe have instantaneous effects around the world. In short, the diffusion of economic and political power in a vastly more prosperous world, joined by a multitude of economic and political interests, has made international cooperation a necessity of modern political life.

Third, the relative decline in military and security concerns has highlighted more clearly the strong mutuality of economic interests. In such a world, U.S. domestic and international economic policies and support for democratic governments now play the critical role in advancing our strategic interests. Recent events in Eastern Europe, as well as in Panama and Nicaragua, underscore this shift.

The rise of economic policy as a compelling force in world affairs has not been sudden.

The reconstruction of Europe and Japan following World War II and subsequent development efforts within developing countries were fueled in large part by generous U.S. aid and liquidity flows in support of democracy, political stability, and stronger economies. Today, flows of that relative size neither can nor should be generated by the U.S. alone. In most cases, these funds were used to develop economies more closely managed than our own. The managed approach to economic growth brought extensive regulation of economic activity, including controlled capital markets. This approach brought success and prosperity to many nations, but it could not be sustained in the context of expanding global trade, growth, and economic interdependence.

The breakdown in 1971 of the fixed exchange rate system which had prevailed since 1944 gave us the first clue that domestic economic policies could not remain isolated from international economic forces. Over the next two decades, the floating rate system coped with a magnitude of change not before seen in the international financial system. This system carried us through a period in which sharp increases in oil and other commodity export earnings and inflationary spending policies in many countries, among other factors, postponed further needed steps toward market-based economies.

In the 1980s, the economic realities which had been disguised by events and policies of the 1970s could no longer be contained. Nations began increasingly to face up to the need to deregulate and allow greater freedom for market forces. The United States and the United Kingdom led the way in government deregulation, which is still a central focus of structural adjustment efforts within the OECD. Such adjustment is now a fundamental element of developing countries' economic reforms as well. Today East European countries are undergoing the most dramatic adjustment of entire economies from managed to more market-based. Even the Soviet Union is facing some of these realities.

The Challenge

As we proceed into the next decade, we must advance U.S. interests in an increasingly integrated and interdependent world economy. To do so, the United States must accept a new reality: the development of strong European and Japanese economies -- which was a fundamental objective of U.S. foreign and economic policy in the post war era -- has resulted in a diffusion of economic and political power that now constrains our own relative position of power and influence in the world.

The challenge for the U.S. is to know how to execute leadership in this new, more complex world -- and also how to restore a more productive, competitive, and balanced U.S. economy to show the way. Some observers have, in my view, misinterpreted the evolution of the world economy and claimed, alarmingly, that the U.S. is in decline. It is true that we must address our internal economic problems. To conduct a satisfactory global economic role, we must reduce our fiscal and trade deficits and boost domestic savings and investment. The importance of facing those tasks cannot be ignored. But we must also keep our sights on the challenge of leadership: how to advance U.S. interests and economic wealth within the larger, more prosperous, more competitive, and more democratic world we have helped to create.

Economic Policy Coordination

Our fundamental objectives today are to promote freedom and democracy, world economic growth with low inflation, more market-based economies around the world, and an open trading system. To pursue these goals, we must discipline ourselves to maintain a strong domestic economy and provide leadership in all aspects of world affairs.

In today's integrated and interdependent world economy, economic developments have broad international implications. Events in other nations affect us, and we depend on the cooperative efforts of other nations to help us achieve our own economic objectives. Only by working together can we all achieve economic performance and policies consistent over time with sustained global growth.

Responding to this basic reality, the United States, working with its major allies, has led international efforts since 1985 to develop the Group of Seven economic policy coordination process.

An assessment of the economic performance of the major industrial countries is the clearest indication of the success of economic policy coordination. Prior to the advent of the coordination process, large fluctuations in exchange rates, widening external imbalances, and looming protectionist pressures dominated the global economic scene. Since that time, we have seen important accomplishments: a continuation of sustained world growth, generally low inflation, reduced external imbalances, and greater stability in exchange markets and exchange rates which are more consistent with competitive realities. Protectionist forces have also been held at bay.

The coordination process has provided a regular forum for policy-makers to consider the international implications of their domestic policies as well as the effects of international developments on domestic economic conditions. It has also encouraged concrete actions to improve the functioning of the world economy and monetary system. As we look to the future, economic policy coordination will remain essential to meeting global economic challenges. These challenges are likely to be substantial. The coordination process will provide a critical forum for helping the major industrial countries to adopt the concrete steps necessary for sustaining expansion and reducing external imbalances.

Competition with our Allies and Promoting Free Trade

As we seek to work with our allies to advance global economic growth and stability, we also face challenges in our relations with them. This circumstance arises in part from the fact that, as Japan and the European Community have emerged as major world economic powers, the U.S. has faced stiffer global competition. Sound domestic economic policies which take into account world economic developments can make us more competitive and can help ensure that the evolution of the world economy produces benefits for us all -- in particular in the form of a free and open trading system.

As Japan expands its role in the international economy, we are confronted by ongoing imbalances in the economic relations between our two countries that require action outside established multilateral fora. In a broad effort to address the underlying causes of difficulties in U.S.-Japanese economic relations, Treasury proposed the Structural Impediments Initiative (SII) to identify and remove structural impediments to adjusting payments imbalances. Through this mechanism, the U.S. and Japan are able to discuss unfair or inefficient practices within each other's economic system. Our broader objective is to ensure that structural characteristics of our national economic systems do not undermine the development of a more integrated global economy. To date, we have held several rounds of talks, and now that the election process is complete in Japan and the new Prime Minister have held their own direct talks, we look forward to concrete near-term progress.

The SII initiative was based on Treasury's proven formula for addressing concerns bilaterally through the Yen/Dollar Talks. Begun in 1984 to foster open international financial markets -- by internationalizing the yen, assuring foreign firm access to Japanese capital markets, and liberalizing these markets -- these negotiations have produced significant progress. Further steps are needed, however, to transform Japan's financial system so that it is truly market-based. Through the new U.S.-Japan Financial Markets Group which began meeting last November on a variety of U.S. and Japanese financial market issues, we will press for further deregulation to improve equality of opportunity for foreign firms operating in Japan.

At the same time, we must work to protect U.S. interests as the European Community moves toward closer economic union. The United States should benefit from reinvigorated efforts to integrate the European Community. We must work to ensure, however, that integration results in an open and growing Europe. Our initial fears that EC 1992 could result in a "Fortress Europe" have been greatly reduced. Proposals regarding reciprocity in banking have been modified over the past year to be potentially less discriminatory. We can protect our interests by remaining constructively engaged with our European allies as they move forward in this area.

But we must also prepare for new opportunities and challenges that will face us once integration is underway. Treasury chairs an Economic Policy Committee on European Monetary Reform and Financial Liberalization which is analyzing the implications for the United States of financial changes in the EC. We are also leading the Administration's effort to analyze and develop a national financial services strategy to focus on the structure and competitiveness of the U.S. financial industry worldwide.

The United States will also increasingly have to respond to the emergence of the newly industrialized economies as key players in the world trading system. We are already involved in bilateral discussions to ensure that their exchange rates are market-determined and consistent with underlying economic fundamentals. We are also seeking to open and liberalize their financial markets. More systematic contact between these countries and other major industrialized economies will also promote their conformity with general trade and financial practices.

Bilateral efforts to manage economic relations with our allies are fundamental and, moreover, are complementary to the broad U.S. effort to advance free markets worldwide. The U.S. has been the prime mover in focussing the multilateral Uruguay GATT Round negotiations on the need for more effective discipline in key areas such as agriculture, services, and textiles. In addition, we are pushing in the OECD for additional multilateral limitations on the use of trade-distorting export credit subsidies. Making real progress in these areas will provide tangible benefits to the United States and simultaneously strengthen the global trading system.

Advancing Democracy and Economic Reform in Eastern Europe and the Developing World

The shift in the global military and political balance and the increasing importance of economic well-being to people around the world suggests that long-term stability -- as well as democratic liberalization and the expansion of free markets -- is best advanced by unlocking the economic potential of free markets. This must be one of our guiding principles in seeking to assist both developing nations and the new democracies in Eastern Europe in the period ahead.

U.S. economic interests in these regions can be advanced through a number of vehicles: the IMF and World Bank Group, bilateral assistance policies, coordinated efforts within the Paris Club of official creditors, and policies to encourage private trade, investment, and financial flows.

The international financial institutions provide the fulcrum for international cooperative efforts to enhance global economic growth and well-being. The IMF, as the cornerstone of the international monetary system, and the World Bank, as the premier development institution, have vital roles to play in assisting developing countries in adopting sound economic policies and in catalyzing international financial support for those efforts.

Their efforts stand at the heart of the international debt strategy, which depends first on the adoption of fundamental economic reforms, buttressed by Paris Club reschedulings and new financing by official creditors, and by commercial bank financing packages which include debt and debt service reduction and new financing. This strategy is producing significant results in addressing individual countries' debt burdens -- notably in Mexico, in the Philippines, and in Costa Rica. Discussions with Venezuela are also nearing conclusion and are underway with Morocco. Brazil may pursue a similar path once it has completed its Presidential transition and adopted an economic reform program. We anticipate that countries such as Bolivia, Ecuador, Nigeria, and Uruguay will soon begin or resume discussions as well.

Through the IMF and the multilateral development banks, U.S. financial support for developing countries can be leveraged several-fold, making these institutions a critical element of U.S. international economic policy. Our continued leadership in these institutions will depend both upon our ability to deliver our share of new financing commitments to support their activities, and on our ability to work with others within the institutions' Executive Boards to advance common interests.

East European countries will look to these institutions to play a central role in providing financial and policy support for their efforts to restructure their economies away from central planning and toward a stronger private sector and more open markets. The creation of a sound European Bank for Reconstruction and Development that promotes this transition away from command economies toward private markets can provide important additional support to complement these efforts.

To help Eastern Europe and the developing world achieve their development aims and become productive contributors to the global economy, other policy instruments will also be important.

Bilateral assistance remains a critical tool for supplementing the development work of the international financial institutions and providing balance of payments support. Our bilateral economic assistance allows us to target countries and regions of particular interest to the United States. Nonetheless, this advantage is diminished by inflexibilities in the distribution of aid. To respond in a truly effective and timely way to events around the world, we need to maintain the maximum level of flexibility and discretion. Putting these resources to efficient use in fostering long-term, sustainable economic growth and development will, of course, depend on clear linkage to sound economic policies.

Bilateral economic assistance is also particularly well-suited to advancing humanitarian goals and building momentum for development -- efforts of particular concern to the U.S. in Africa and the poorer nations in Asia and the Caribbean. Although bilateral aid flows continue to play an important role in other regions and in specific countries, we may increasingly want to focus on "graduating" more advanced developing countries to other forms of assistance. In the context of credible economic programs which successfully build confidence in developing economies, trade and investment are important and feasible potential vehicles for fueling growth.

In Central America, we are currently moving forward with specific policy steps to support critical political transitions. Responding to events in this region in a timely way is critical. In particular, the Administration needs your support on the reallocation of funds to support Panama and Nicaragua.

Facilitating trade, investment, and private sector involvement is likely to be particularly relevant as East European economies proceed with adjustment, liberalization and, in turn, expansion. Although recent developments have created an impression that bilateral aid flows would shift sharply to Eastern Europe, bilateral aid will play a secondary role to our efforts to engage the private sector in these countries as we help them to develop market-oriented economies.

Conclusion

In short, economics are increasingly dominating world affairs. To advance U.S. interests successfully in this evolving and increasingly interdependent world, we must assert strong leadership in the context of international cooperation. The Administration is working hard to meet this challenge. We hope we can count on Congressional support and cooperation in this effort.

Thank you.

Mr. **Obey**. Thank you.

I am going to depart from usual practice this morning and will withhold my questions until other members of the Committee have had an opportunity to ask questions for five minutes. Let me just get a housekeeping matter out of the way first.

PANAMA/NICARAGUA SUPPLEMENTAL APPROPRIATION

Mr. Bartholomew, the President has asked us to act on his Panama/Nicaragua request as quickly as possible. He set a deadline of April 6th by which he would like to have action. To comply with that, we have scheduled a hearing for next Monday at 2:00 p.m. The problem, however, is that we still do not have the legislative changes from the Administration that we have to have before we can proceed with the hearing. All we have at this point are the changes which you are suggesting in the actual appropriated accounts, but there are a number of changes in law which have to also be provided. We do not yet have that from the Administration. Until we do we cannot proceed.

Mr. **Bartholomew**. Mr. Chairman, I thought that you had all that you required to act on that.

Mr. **Obey**. No, sir.

Mr. **Bartholomew**. I am unaware of the shortfalls that you are talking about, and we will take the question——

Mr. **Edelman**. If I may, my folks say you will get it today, Mr. Chairman. There is not that much on Nicaragua. It is Panama that requires the most work, as I recall. But you will have what you need today.

Mr. **Obey**. Well, we need it.

Mr. **Edelman**. I understand.

Mr. **Obey**. We cannot hold the hearing if we do not.

Mr. **Edelman**. We understand completely.

Mr. **Obey**. Mr. Lewis?

NICARAGUA AGRICULTURAL ASSISTANCE

Mr. **Lewis**. Thank you, Mr. Chairman. Mr. Chairman, I would like to concentrate my time on questions that are very specific, concerning problems in Central America.

I had the occasion last week, as did some of my colleagues, to meet with Francisco Mayorga, a financial advisor to Mrs. Chamorro. One of the most striking topics of our discussion involved their immediate need to get the economy moving. The agricultural sector of that economy is fundamental, and the growing season is upon them—April and May are critical times. I would like to ask the State Department and A.I.D. what we are doing specifically to assist them with that immediate challenge.

For example, if April is a critical time in terms of getting seeds and insecticides to make sure that the farmers have something to plant, what are we doing to assist? I understand that at least half of the property involved is in state farms under the recent regime?

What are we doing to get specific get information about how much seed they need, what kind of seeds and, what kind of insecticides? Do we have people in the field who have that information? What are we doing today that is helpful?

Mr. **Edelman**. Let me answer the question as best I can, Mr. Lewis, because it is indeed something driving the President to ask for prompt action from the Congress on the whole package.

I also met with Mr. Mayorga when he was here, and we fully understand that problem. He is at a disadvantage, and we are all at a disadvantage, because he does not know, and the Sandinista regime has not told him, what is in the warehouses.

We are trying to assist him, and he is trying to find out what they might have and what the specific types of needs may be. To be honest with you, I think we are going to have to, with them, work and guess a bit.

We are talking with other agricultural institutions in Nicaragua. We are talking with other donors in Nicaragua and with him to identify the specific needs as best as we can, because we really cannot wait, and the people of Nicaragua cannot wait, until they assume power on the 25th of April to start doing these assessments.

We intend, within the next two weeks, to send a team of experts into Nicaragua to get a handle on these exact questions if we can get visas. I have heard preliminarily that the current government, the government of Mr. Ortega, will give us visas, but I do not know if that is definitive yet.

At the same time, in fact just yesterday, I instructed my staff to start working on all of the A.I.D. paperwork, which is legion, so that when legislation is signed by the President on the 5th of April we should be able to hit the ground running.

Although we have not discussed it yet with the Committee, I hope we could come up shortly with a congressional notification so that we can start the 15-day count on all of these funds before the bill is passed. I understand there is some precedent to do that. We are going to try and work this out with all of the relevant committees so that when the President signs the bill, we can move out.

So we are sending people down to Nicaragua. We are talking to the few international agricultural institutions that exist there. We are starting now on the assumption that we will have money on April 5 and A.I.D.'s paperwork will be done.

Mr. **Lewis**. Is State playing a role in trying to coordinate with our experts in the Ag Department and in A.I.D.?

Mr. **Bartholomew**. Yes, indeed we are, Mr. Lewis, and I think that what I can add to what Mark has said on this, we are hoping to get that team down there as soon as possible. We do have information that helps us in terms of a perception of the situation and how to react to it.

For example, Mrs. Chamorro sent an economic team up here last week. We had a chance to review Mr. Mayorga's concerns. We are working closely with A.I.D. on this.

Mr. **Lewis**. It is almost too late already. It is one thing for us to talk about wanting to help freedom and democracy, but a full stomach is fundamental, and if this planting season fails it will be in part our fault. So I would really like to have you give the Committee specifics as to what you are doing and what your time frame is, starting with last weekend continuing through next week. It is that urgent.

Mr. **Edelman**. We will be glad to give that to you.

ROLE OF MULTILATERALS IN CENTRAL AMERICA

Mr. **Lewis**. Mr. Mulford, you and I have had a chance to have some recent exchange on this issue. Would you share with the Committee and with me what we are doing and what we can do to raise with the multilaterals our great concern that aid be designed to stimulate private sector and private business, private market development versus government to government kinds of development?

Mr. **Mulford**. Well, let me focus on the two main countries in question at the moment, Panama and Nicaragua. In the case of Panama, there are as you know substantial arrears to international financial institutions. Among the other things we are doing to provide flows of resources to Panama, we are also trying to find ways to speed up the removal of those arrears, because that will reopen important flows of resources and policy advice to the countries.

In the case of Panama, it is a question of restarting an economy that had a large and impressive private sector. In the case of Nicaragua, I would say it is a question of rebuilding an economy where the damage is perhaps much more fundamental, and the need to sort of make major reforms that are more market-opening types of reforms is clearly critical.

In Nicaragua, does not have arrears to the IMF, for example. They do have other arrears to the World Bank and to the Inter-American Development Bank which we hope can be removed relatively quickly. But there is no reason why these two countries cannot commence conversations with the international financial institutions and begin to seek advice and prepare programs for implementation as soon as possible.

Mr. **Lewis**. Just adding to that just a second, my information indicates that in the country of Bolivia there has been great resistance on the part of the banks to move in the direction of voluntarily becoming involved in restructuring of loans, et cetera, specifically the bank's willingness to participate in restructuring in Bolivia.

Mr. **Mulford**. Well, the banks did participate in a cash buy-back exercise which had a substantial impact on reducing Bolivia's outstanding bank debt. The banks are now looking at the possibility of further restructuring, but their willingness is not so pronounced as it is in the case of direct cash sales. So you are right, we are concerned about the attitude of the banks, but we are hoping that in the coming months we can see some progress there.

Mr. **Lewis**. You are hoping for some movement there? I am hoping for some, as well.

Mr. **Mulford**. Well, as you know, our capacity to actually direct the commercial banks—private banks—is limited, but I think the important point about Bolivia is that they have already made very substantial progress in reducing their outstanding burden of commercial bank debt. The next question is, how does another round of this activity take place?

Mr. **Obey**. Mr. McHugh?

Mr. **McHugh**. Thank you, Mr. Chairman, and thanks to our distinguished panel for being with us this morning.

SUB-SAHARAN AFRICA

I have a number of questions on Africa which I suspect I will not be able to get to in our session this morning and which I will submit for the record.

[The information follows:]

Submitted to Department of State

LIBERIA

Question. Given the deteriorating human rights situation in Liberia, does the Administration still plan to provide $1.4 million in military aid to that country this year? If so, why?

Answer. Since the government of Liberia is currently under Brooke sanctions, no US military assistance is available to Liberia. Should the Liberian government make payments sufficient to remove the sanctions, the Department would consider the then-current status of human rights of Liberia before proceeding with any military assistance.

Question. Concern has been expressed that U.S. military personnel are advising the Liberian military, which has engaged in the indiscriminate killing of innocent civilians. Could you explain what role, if any, U.S. military personnel are playing (or did play following the December coup attempt) with the Liberian military?

Answer. Two members of the U.S. Military Mission in Liberia accompanied the then newly-named Liberian Armed Forces Zone Commander General Moses Craig to Nimba County at the end of January, 1990. The two members of the Military Mission had orders to provide counsel to General Craig on restoring order and discipline in the AFL. General Craig was appointed on January 22 after President Doe had removed his predecessor for failure to curb military excesses against civilians in Nimba County. The two U.S. officers remained in the area for some ten days and then returned to Monrovia. We believe that their presence helped curb abuses during that time.

All mission personnel, including U.S. military personnel, are making clear to their Liberian contacts that human rights abuses will not be tolerated, and have a deleterious impact on the bilateral relationship.

Question. What development priority do you give sub-Saharan Africa?

Answer. We and the other donors recognize that the most intractable development problems in the world today are concentrated in Sub-Saharan Africa. This region, with almost 12 percent of the total population of less developed countries, receives about 30 percent of official development assistance, including several Africa-specific programs.

The creation of the Development Fund for Africa (DFA) in FY 1988 was explicit recognition by the Administration and the Congress that Africa has special economic development needs. Our request for the DFA has increased over time—the FY 1991 request is 12 percent higher than the FY 1988 request. The decrease in Economic Support Funding (ESF) over the same period, however, reflects both the fact that the account has been funded at levels significantly below the Administration's request, and the fact that startling changes of strategic significance, most notably in Eastern Europe, have required us to shift part of our limited ESF resources to meet new demands.

In addition to U.S. bilateral funding, the are many other avenues through which we channel our assistance. Examples are international financial institutions such as the World Bank's International Development Association (IDA) and the African Development Bank, as well as the African Development Foundation established by Congress in 1980, United Nations organizations, and a score of private voluntary organizations. Indicative of the significance of our role in African development funding is the fact that the United States is providing a major portion of the IDA IX replenishment, nearly half of which will be used for Africa.

Severe constraints on foreign assistance and the competing great needs in other parts of the world restrict the overall magnitude of the Administration's request for the Development Fund for Africa for FY 1991.

Question. Instead of providing a little funding to so many countries, why not concentrate those funds in those countries that are making a serious effort to address their development problems so that our funds can make some difference?

Answer. The efforts being made by and the development prospects of beneficiary countries are very important factors taken into account by A.I.D. in determining priorities for extending development assistance to Africa. Given the constraints on our foreign assistance resources, we are able to support with only small programs some African countries making serious efforts to reform their economies. Such small programs also support our assistance objectives. Even very limited programs demonstrate that when a country's policies move in a positive direction, the United States should and does support those efforts materially.

IMPACT OF U.S. DEVELOPMENT ASSISTANCE IN AFRICA

Question. What evidence exists that putting U.S. development assistance funds into Africa over all these years has made any difference in improving the standard of living for the average African?

Answer. Achievements related to A.I.D.'s ongoing assistance that have occurred since the DFA was initiated include:

Macroeconomic stability: Nearly half the DFA priority countries made substantial progress in FY 1989 in ensuring that their fiscal, monetary, and sectoral policies are flexible enough to adjust to changing economic conditions. Countries undergoing adjustment have had substantially higher growth rates, both of total and agriculture, than countries that did not adjust.

Reducing Public Sector Involvement: At least six of the 20 DFA priority countries have made strides in reducing public sector involvement in areas better suited to private investment and risk-taking. For example, in Cameroon, financial gains to the Government and to farmers resulted from A.I.D.'s support for liberalization of fertilizer import and distribution and provided a welcome spot of relief in 1988/89 for the country's stressed economy.

Public Service Delivery: The needs in Africa for public services are enormous—and it is clear that African governments feel a responsibility for providing them. Family planning is an example of where A.I.D. has assisted in increasing the effectiveness and efficiency of service delivery. In 1988/89, for the first time ever, four African countries recorded declines in fertility rates. These figures in Botswana, Kenya, Swaziland and Zimbabwe provide evidence that a public commitment to providing family planning information and services can yield results.

A.I.D. and African country experience is convincing: the movement toward free competitive markets is necessary to generate self-sustaining development and growth. For example, the direct effects of A.I.D.'s commodity import program on markets in Mozambique's capital city of Maputo are visible as local agricultural production has expanded to meet demand.

Agricultural Research: A recent evaluation of A.I.D. and other donor assistance to the Malian national crop research system estimated that the research had benefitted approximately 150,000 hectares of farmland in recent years and that the value added each year at the farm level was in excess of $8 million.

Training to Improve Job Productivity: Training is a key aspect in the success of virtually all development assistance to Africa. In Swaziland, for example, an innovative program is developing linkages between traditional and modern sectors, improving the quality and quantity of staff in the primary education system, and establishing basic standards for the accounting profession. The in-country training opportunities are so popular that project output targets will be met ahead of schedule.

Famine Preparedness: 1988 and 1989 saw relatively good agricultural conditions in most drought and famine-prone countries in Africa. In less fortunate Ethiopia, early warning systems led to early identification of severe production shortfalls in 1989 and facilitated the early mobilization of food aid to prevent mass starvation.

Increased Agricultural Production and Utilization: Progress has been made in raising agricultural production in sub-Saharan Africa. This progress has been due at least in part to change in economic policies, improvements in marketing, and progress in agricultural research—broader changes that A.I.D. has been able to support because of the flexibility of the DFA.

Meeting the Needs of People at Nutritional Risk: Food security depends on production increasing as fast as population growth, or on incomes rising enough to permit needed food purchases. Neither of these conditions holds across Africa; food aid is, therefore, a principal resource for making a direct, short-term impact on food security in the region. In FYs 88-89, about three million metric tons in food commodities—or approximately 803 million person-days of food—were provided to 37 countries in sub-Saharan Africa.

Question. Which countries are the major successes and did we contribute to their success? If so, how?

Answer. we can report a number of apparent success stories at the country level, inlcuding, among others, Mali, Mozambique, Niger and the Gambia.

MALI

Sustained productivity in Mali has been hampered by cyclical droughts, low levels of technological development, shortages of trained people and a tradition of state interference in the economy. A number of these constraints have been markedly alleviated, in many cases through projects undertaken directly by A.I.D. or in collaboration with other donors, but a great deal remains to be accomplished. The most visible achievements have been in the area of economic policy reform.

A.I.D.'s Economic Reform Program grant has been most successful. It lifted many of the constraints confronting the private sector, including (a) price controls, (b) onerous taxes and commercial code and (c) import and export licensing, raising private sector production, investment and employment. These reforms helped contribute to the country's 9% increase in real output in 1989.

Contrary to expectations, elimination of price controls led to price reductions rather than price increases. Overall, prices fell 13.3% in 1987, compared to an inflation rate of 8.9% two years earlier.

Tax reductions also had a positive effect. Survey results indicated that 16% of the firms said that tax cuts were instrumental in their decision to make new investments, while another 27% said that they had hiked employment, at least in part, in response to the reduction in the payroll tax.

MOZAMBIQUE

For the past decade, Mozambique has been afflicted by intermittent drought and a rural insurgency that has made the country dependent on extenal assistance for its basic food needs. By necessity, initial A.I.D. efforts concentrated on quickly delivering assistance to end beneficiaries. Immediate impact was critical.

Through DFA-supported commodity import programs, we have provided commodities, including seeds, fertilizer, tractors, agricultural implements, and transport equipment. These commodities have helped revitalize commercial farming in Mozambique.

Under these programs, the Government of Mozambique has eliminated price controls on a number of key agricultural commodities and allowed private trade in these commodities. The Government also has moved to reduce the acreage of state farms and to expand private farming.

In part attribute to our assistance, real output is now growing 4% per annum, compared to a minus 13 percent per annum over 1982-85. There also has been a substantial rise in the production of the family farm sector, most notably a doubling in cotton output.

NIGER

Agricultural production in Niger is hampered by marginal rainfall, periodic insect invasions and drought, yet 90% of the workforce in Niger is dependent on agriculture.

Under the Agricultural Sector Development Grant, a comprehensive reform program was implemented, including (a) reducing input subsidies to 15%, (b) increasing private sector marketing of agricultural inputs, (c) abandoning uniform national grain pricing, (d) expanding private sector marketing of grains, (e) creating and expanding village level grain banks, and (f) reducing regulations on cowpea and livestock exports.

As an out growth of these reforms, private trade in agricultural inputs and commodities has expanded substantially. The drain on government resources in operating the parastatals involved in grain and input marketing has been reduced by roughly $10 million per year.

GAMBIA

Our relatively modest program for this small, resource-poor democracy has focussed in recent years on support for the Gambian Reform Program. The Program received support from A.I.D. as well as other donors in the areas of financial assistance, conditionality, and technical support. A.I.D.'s technical support, provide by the Harvard Institute for International Development, played a small, but crucial, role in a reform process now widely recognized to have resulted in increased per capita income, particularly in the rural areas (where the poorest Gambians live), increased agricultural output, and expanded trade.

As a result of the economic management policies now in place, The Gambia has make considerable progress in reducing internal and external imbalances and strengthening its growth potential for the 1990s. Annual GDP growth was estimated at 4.6% for the 1988/89 period. Key reforms have been implemented, including liberalization of the trade system, reform of the exchange system, the introduction of flexibility in interest rates, the promotion of private sector activity through the provision of appropriate price and other incentives, and greater efficiency in public sector operations.

These reforms have led to increases in agricultural production (in spite of adverse weather conditions and locust infestation), a decline in the rate of inflation, an improvement in The Gambia's external position (including a reduction in external payments arrears which will enable it to more easily service its debt), a significant decline in the budget deficit, and stabilization of the foreign exchange market.

Question. How has the flexibility provided by the Development Fund for Africa helped in allocating scarce resources? In other ways?

Answer. The elimination of functional accounts makes it much more feasible to shift resources more quickly to programs and activities which are working. As a result, our program is becoming much more performance-based. Between FY87 and FY91, counting both DFA and ESF:

We have tripled resources allocated to ten top performers from $48 to $158 million (Burundi, Gambia, Ghana, Guinea, Madagascar, Malawi, Mali, Mozambique, Tanzania and Uganda).

We have drastically reduced the resources allocated to politically important countries which over the past two years have been unable to reform their economies (Liberia, Somalia, and Sudan).

Not only does DFA provide flexibility at the level of country allocations, but it also provides flexibility in shifting resources from activities that are not working to those that are. This would have been difficult if not impossible in the era of functional accounts.

To abet this process, A.I.D. is establishing a system of monitoring and evaluation that will enable us to determine whether or not programs are working at the level of overall country programs, as well as the individual project level.

Under the DFA, our programs are now more relevant to Africa's problems:

Policy reform is a major development requirement in Africa, and non-project assistance is often the best way to support and encourage such reform. By 1991, we will have policy reform programs in twenty-three countries. Before the DFA, policy reform programs were largely limited to ESF recipients. Budgets were located in and could not be adjusted easily to respond rapidly to changing policy issues. The only way to run the African Economic Policy Reform Program prior to 1988 was to fund it out of ESF.

By using sectoral assistance to support improved social and economic services, we are focussing on systemic problems rather than problems more limited in scope and effect. We believe this is a more effective way of getting at development constraints.

The DFA has allowed the U.S. to play a leading role in the Special Program of Assistance for Africa through which the World Bank and donors are making several billion dollars available for support to Africa's restructuring programs. Since we are no longer constrained by functional accounts, we are better able to integrate projects in several different sectors to achieve one development strategic objective. For example, on-farm and off-farm activities can now be directed at improving rural incomes, something that was very difficult to do under functional accoutns. Also, the Malawi mission intends to combine activities in the small enterprise area with activities in estate and smallholder agriculture in order to provide employment for the burgeoning labor force.

The functional account system virtually excluded A.I.D. involvement in many areas crucial to development (financial sector development, non-agricultural private sector activities, transport), since there was so little funding allocated to the private sector account. We are now better able to become involed in solving key development problems no matter what sector they are in.

Question. Why do we need to maintain a development program in Africa at all if we cannot provide adequate funding for it? Why don't we simply allow multilateral institutions and other donors to deal with Africa?

Answer. While we agree that the development resources we are able to make available to Africa are inadequate to meet demonstrable, legitimate needs, that does not mean the development effect of our contribution is negligible. On the contrary, we believe that U.S. economic development assistance to Africa is important to the accomplishment of U.S.G. objectives on the continent. Moreover, we are convinced that the United States has a unique fund of valuable expertise and experience not available from other sources, funding issues aside. Our development assistance is designed to exploit as fully as possible our comparative advantage in this area. Nor can we responsibly simply abandon to others our own national commitment to assist less economically developed countries.

Question. Don't our small programs simply amount to "walking-around money" for American Ambassadors?

Answer. Under the Development Fund for Africa, funds are allocated on the basis of economic performance and need, criteria which enable us to achieve maximum development impact with scarce resources. In countries which receive limited U.S. assistance under these criteria, we continue to seek maximum development impact for our resources.

Such activities include the Ambassador's Special Self-Help and Human Rights projects, participant training, private voluntary organization projects and feeding programs, "women in development" activities, as well as regionally managed projects, all of which are means of promoting grassroots economic and democratic development. They visibly demonstrate our commitment to improving the economic status of the poorest members of a society.

Question. To what extent has economic structural adjustment succeeded in Sub-Saharan Africa? Where has there been significant progress as a result of A.I.D.'s efforts?

Answer. A study published by the World Bank last year *(Africa's Adjustment and Growth in the 1980s)* strongly indicates that economic structural reform and economic growth are not only compatible, but that implementation of the former encourages the latter. Data included in the study show that the nineteen sub-Saharan countries which the Bank judges have "strong overall reform efforts" also have enjoyed substantially better economic performance in recent years than those who have made weak efforts in reform. Of these nineteen countries, thirteen are also among the largest African recipients of American development assistance; strong reform programs are an important, but not the sole criterion for A.I.D. emphasis.

We do not wish to suggest that our assistance has been the only, or even the most important, reason for the successful combination of reform and growth. The essential factor is and will remain the reform commitment of each each country. However, it seems clear that the strong correlation between reform and growth, on the one hand, and American development assistance, on the other, is not coincidental.

Question. Why did the U.S. vote against the UN ECA Alternative Framework to Structural Adjustment Programs?

Answer. While we welcome contributions by the UN Economic Commission for Africa (ECA) and others to the debate on the very important issue of structural adjustment, we could not support the resolution put forward during the 44th UN General Assembly on the ECA Alternative Framework because the resolution was phrased in such a way as to characterize it as a preferred alternative to IMF/World Bank, structural adjustment programs. While we believe that certian elements of the Alternative Framework can be usefully incorporated into existing adjustment programs, we continue to believe that the discipline and expertise accompanying IMF/World Bank structural adjustment programs cannot be replaced adequately by any alternatives that have been proposed so far.

Question. Is the existing World Bank-IMF framework sufficient to take the needs of poor Africans into account?

Answer. Present World Bank and IMF programs are essential for the achievement of our economic development efforts in Africa and elsewhere. No less important are the programs of the UN and other multilateral institutions as well as the contributions of bilateral donors, such as the United States.

The existing framework is being re-oriented to include consideration of poverty issues. Increasingly, programs include important reforms to improve the well-being of the poorest segments of society and to address underlying causes of poverty, such as environmental degradation and unbridled population growth.

Aid to Zaire

Question. Why should Zaire, a country beset with massive corruption, human rights abuses, and economic mismanagement, be the second largest recipient of DFA (Development Fund for Africa) assistance in fiscal year 1990?

Answer. Zaire is deserving of continued relatively high levels of assistance based on the considerable needs of its large population (over 33 million) and its general compliance with the renewed IMF/IBRD structural adjustment program. Zaire is one of the poorest countries in Africa, with a per capita income of only $170 per year. Despite this, on a per capita basis, Zaire is only an average African recipient of A.I.D. resources.

A.I.D.'s program in Zaire is focused on private sector development, agricultural production, restoration of transportation infrastructure and preventive health care and population services primarily directed at child survival. Assistance is channeled through private voluntary organizations and non-governmental organizations to the extent possible. Corruption in A.I.D.-funded programs has not been a problem as a result of USAID/Zaire's strict monitoring of all resource flows, combined with regular audits. Thus, development assistance funds supplied by the United States to Zaire benefit the Zairian people as a whole.

Question. Doesn't this make a mockery of the claim that DFA funds are allocated on the basis of good economic performance?

Answer. To date the Government of Zaire has met IMF performance criteria for its renewed strucural adjustment program. A central objective of our A.I.D. program for fiscal year 1990 is to encourage and support structural reform. We are, therefore, carefully assessing the implementation of the program and its implications for our assistance programs.

Question. How does our economic aid progam in Zaire help improve the lives of the average person?

Answer. Our economic progams to Zaire are designed to improve the well-being of its citizens and further the country's economic devleopment. They are directed toward improving agricultural output and the health of the population while supporting economic reform. All of these activities can help improve the lives of the average person.

USAID's primary agricultural objective is to increase output from small farms—particularly food production—to raise national and individual incomes and improve nutrition. This is supplemented by projects to expand from-to-market access by improving local rural road and river transport systems.

The health and population portfolio focuses on implementing a child survival strategy, and increasingly on integrating AIDS prevention activities. The Basic Rural Health program is active in 80 of Zaire's 306 health zones and provides almost 4.5 million rural Zairians with access to full-service health care. There are projects to improve drinking water sources and practices and to provide technical support for immunizations, oral rehydration therapy, and malaria-control interventions in 206 health zones, covering nearly 80 percent of the population. In addition to family planning services, there is a nutrition program focussed on Kinshasa and a School of Public Health Project, managed by Tulane University, to train public health workers.

Human Rights in Zaire

Question. What is the direction-trend of human rights over the last year?

Answer. The 1989 Country Report on Human Rights Practices in Zaire states that "human rights in Zaire continued to be circumstanced in 1989 in such basic areas as freedom of speech, press, assembly, and integrity of the person." The report notes, however, that there were improvements in some areas, e.g., the efforts of the Judicial Council and the Department (Ministry) of Citizens' Rights and Liberties to prevent human rights abuses, regularize arrest authority and procedures, and moderate prison conditions. Nevertheless, there remains substantial room for improvement.

The human rights situation in Zaire is a frequent subject of discussion between our government at all levels, and it is our firm policy to urge the Zaire government to make more substantial efforts to improve the human rights environment there.

Sudan Military Assistance

Question. The Associated Press reported on March 8 that the Administration has provided $25 million a year in military help to Sudan through "other programs" as a way to end-run Congress. Do such "other programs" exist?

Answer. There are no "other programs." U.S. military assistance to Sudan was provided through regular security assistance programs. All such assistance stopped after the military takeover of June 30, 1989.

Question. How much U.S. military aid has reached Sudan in each of the last three years through any spigot?

Answer. Sudan received the following amounts of U.S. military assistance during the last three fiscal years:

FY-87: $26.184 million.
FY-88: $24.381 million.
FY-89: $21.223 million.

Deliveries in each year consist of items purchased with monies appropriated in earlier years, because of long lead times.

All FY-89 assistance was delivered before the June 30 military takeover. No military assistance has been delivered since June 30, 1989.

Question. Did the resources provided by U.S. military assistance contribute to or facilitate the military takeover?

Answer. U.S. military assistance to Sudan over the years has been intended to strengthen the overall capabilities of the Sudanese armed forces. We see no direct connection between U.S. military assistance and the takeover.

AID TO SUB-SAHARAN AFRICA

Mr. McHUGH. Let me begin by just making an observation. If anyone wants to comment they are welcome to.

As Mr. Lewis has indicated, I think we have responsibilities in Central America, and I am sure the Congress will respond with a supplemental for Panama and Nicaragua. I would certainly support that response, but as we look around the world—and Mr. Edelman, I am sure you can attest to this—and observe the figures on human suffering and underdevelopment generally, sub-saharan Africa is clearly the most desperate part of the world, and I am concerned, frankly, that we are not able or willing to find sufficient resources to respond adequately to these concerns.

In Panama and in Nicaragua this year we are going into the Defense Department budget for a supplemental $500 million request for Panama and $300 million for Nicaragua.

In Namibia, where there was also a recent election, we are talking about $500,000 this fiscal year in terms of reprogramming—no supplemental. Next year I think it is $7.8 million for Namibia.

Now, these are just recent examples and there may be some explanation behind it, but I think they reflect my concern that with regard to sub-saharan Africa, where we do have these desperate problems and where there are transition to democracy issues as well, we are simply not willing or able to come up with anything like the resources we are willing to come up with on short notice for Central America, conceding that Central America is closer to us and we have had more active involvement in there in the past.

But the numbers really are dramatically different, and I hope as we review our foreign policy, including our aid programs, with changes taking place in the world that everyone agrees are dramatic, we will take another look at these really profound problems in sub-saharan Africa.

MIDDLE EAST PEACE PROCESS

I would like to shift in terms of my specific questions first to the Middle East and Secretary Bartholomew, I suppose this question would be best addressed to you.

There are major political changes apparently underway in Israel today, and one of the questions that arises is what implications these changes have for our peace process on which Secretary Baker in particular has worked so hard. More specifically, I think it might be useful for you, if you can, to clarify for the record what the policy of the United States is with regard to the inclusion of Arabs who reside in East Jerusalem in the negotiations that Secretary Baker is promoting regarding elections on the West Bank and Gaza.

Can you first tell us what our position in these negotiations is with respect to Arabs living, or residing, in East Jerusalem and secondly, more generally, what are the implications at the moment, as best you can tell, for our peace process, given what is happening in Israel today?

Mr. BARTHOLOMEW. Mr. McHugh, that is a matter that is under discussion, the first point that you are raising right now. I must say the situation right now quite frankly is so sensitive that I would like to just review briefly some of the major points in answer to the fundamental question that you raised.

We remain committed, in the first instance, to pushing the peace process forward. We think, in fact, the basis has been laid to make progress where that is concerned. We remain ready to work with the Government of Israel in an effort to in fact help that government realize the potential of its own initiative.

Now, it is not our place to make decisions for Israel, and our ability to support and move forward on peace is going to depend upon an Israeli Government capable of making decisions. Israel is now obviously working its way through its own political process to sort out its situation. We will be watching this process closely, and obviously until it is sorted out Israel will not be in a position to make further decisions on the peace process, and with that said, I think I would like to be very careful about making any other comments that could be related to the internal political developments in Israel itself, sir.

Mr. MCHUGH. Well, I do not want to create any problems in the hearing, but if possible I just want to be clear on what you said about our position, our policy with respect to Arabs participating in negotiations who reside in East Jerusalem, and if I heard what you said correctly, it is that that is under review in the State Department and in the Administration?

Mr. BARTHOLOMEW. I do not think that is the case. I would like to provide a very precise answer for you on that point if I may, Mr. McHugh.

[The information follows:]

Our objective remains to initiate an Israeli-Palestinian dialogue which will be effective and credible to both Palestinians and Israelis. To do this, we believe that participation should be as broad as realistically possible. We are aware of the concerns of Palestinians and Israelis about the issue of participation of Palestinians from Jerusalem in the dialogue. We believe that a creative way to handle this issue can be found to satisfy these concerns.

Israel's political system now is in the midst of important internal discussions. I can assure you that once a new government is formed, we will continue our peace efforts. The Administration remains ready to assist the parties in the Middle East toward attainment of a just and durable peace. We remain strongly committed to the security of Israel and to the search for peace.

PEACE NEGOTIATIONS IN EL SALVADOR

Mr. **McHugh**. I would like to turn to El Salvador if I may. We have had this encouraging election in Nicaragua. I have a two-part question.

One is, do any of you see the elections in Nicaragua as having an impact positively or otherwise on the prospects for peace negotiations in El Salvador and, secondly, what is the administration's position, Mr. Secretary, on the role of the United Nations in negotiations in El Salvador?

If I understand the situation correctly, the government of El Salvador has welcomed the participation of the U.N. as have the guerrillas, but there is a difference of opinion as to the specific role the U.N. Secretary-General would play.

The government apparently wants him to play the role of a witness, that is, an observer. The guerrillas apparently want him to play a more active mediating role. Is this correct and what is the policy of the administration with respect to the U.N. Secretary-General's participation in negotiations?

Mr. **Bartholomew**. Well, on the first point let me just say this. I think we would hope that what has happened in Nicaragua would have some very direct lessons in the first instance for the FMLN guerrillas operating in El Salvador.

The fact is, though, the Sandinistas have lost the election, the guerrillas in El Salvador are continuing their military struggle, and we are going to continue to need to support El Salvador with our assistance programs.

And I might underscore the fact here that three quarters of the aid we give them is economic.

Now, on the question of the U.N., I think it is our view that the U.N. role that we have all foreseen in the matter that you are talking about is under discussion to be resolved between the two.

The discussions where the FMLN will have a role to say where that is concerned, I am not aware of the specifics that—and I will need to inform myself further on the specific question of the possible differences of the role of the Secretary-General, Mr. McHugh.

Mr. **Obey**. Mr. Porter.

Mr. **Porter**. Thank you, Mr. Chairman.

I am going to attempt to ask a question or two of each of the panel. I do not know how far I am going to get.

First, let me start by commending Ambassador Edelman for the excellent job that he has done as acting administrator of AID. I think you have done a marvelous job here, Mr. Ambassador, and you are to be commended for it.

A.I.D. DEBT-FOR-NATURE SWAPS

Last year the Congress passed debt for nature swap legislation and toward the end of last year AID concluded a debt for nature swap with Madagascar, which was a first for a government using AID monies. Has there been any additional progress on debt for nature swaps at AID, Mr. Ambassador?

Mr. **Edelman**. First of all, Congressman Porter, thank you for those very kind comments.

Yes, we have decided to participate in another debt for nature swap in Paraguay, with the World Bank and other donors, to help in establishing a forest reserve there of about 170,000 acres.

Let me compliment Pat Coady, the Executive Director to the World Bank, who called this to my attention when it seemed to be going through. He shares my enthusiasm for this type of activity. I happen to personally like debt for nature swaps because of what they do in helping on both debt relief and in preserving biodiversity—in the disappearing rain forest in this case.

This one in Paraguay will take some time to work out. We can leverage our planned $500,000 contribution on about an eight to one ratio. It is a terrifically well-leveraged proposal, and we are looking around for others as well. We do not rule them out.

Congress asked us to set aside about $15 million this year in a special global climate reserve, and we will fund this out of that reserve. Although it is not the kind of country that is specified in the law, I do not think anybody would have any objection to using the money for something that is clearly as meritorious as this. Where there are others where we can leverage so much, especially with such a small contribution, we will look interestingly at those as well.

The one in Madagascar is proceeding apace as far as I know. It has not hit any snags in helping to save those lands.

GLOBAL WARMING INITIATIVE

Mr. **Porter**. Last year the committee started a global warming initiative to have AID help developing countries with efficiency standards and power generation to reduce CO2 emissions. Can you give us an update on that?

Mr. **Edelman**. I cannot. I know we have been working on it, and we have been working with EPA and I will be glad to supply an update not only for the record, but also directly to you.

[The information follows:]

The Agency has nearly completed its Plan and Global Climate Change, which will provide guidance for focusing and expanding efforts to enhance the effectiveness of A.I.D.'s climate change program.

As a component of the new plan, A.I.D.'s Working Group on the Environment has tentatively identified the "key countries" which will be the focus of our global climate change program: Brazil, Mexico, Central America (considered as a single entity for these purposes), India, Indonesia, the Philippines, Pakistan, Poland and Zaire. The composition of this list may change as A.I.D. finalizes the plan.

The key countries were chosen on the basis of their current or predicted emission of greenhouse gases as well as subjective criteria such as A.I.D.'s ability to influence change within the host country, a country's economic vulnerability, e.g., the degree of dependence on its coal reserves or forests for continued economic growth or relative economic wealth.

Focusing resources on targeted issues and countries will increase the effectiveness and impact of A.I.D.'s climate change activities. However, with a fixed budget, targeting resources involves difficult trade-offs between financing a new focus and supporting existing programs, all of which address serious and critical development issues. A.I.D. is in the process of tackling the difficult issue of how to maintain the effectiveness of critical programs outside a key country while increasing resources available for climate change activities in the key countries.

Mr. **Porter**. All right.

ENVIRONMENTAL CONCERNS AND THE EUROPEAN BANK

Secretary Mulford, I liked your opening statement a great deal. It seems to me that our ability to compete in the world, the shape of our own economy, whether we can put our fiscal house in order and increase our domestic savings and investment and have stronger economic growth really will determine whether it is American values that dominate the world scene or whether it is someone else's values in the future, and I have a decided preference for our values, and I think you state the case very correctly.

Let me ask a question about the environment also. Eastern Europe has had a great deal of environmental neglect. It is my understanding that in economic terms the Polish economists estimate that more than 10 percent of Poland's gross domestic product is lost each year due to the astonishing level of environmental degradations. That is incredible.

To what extent do you think that the individuals that are now negotiating the charter of the European Bank for Reconstruction and Development are aware of the relationship between environmental recovery and economic recovery? Are they aware of this and are they going to factor this into their structuring?

Mr. **Mulford**. Yes. In the various meetings that we have held for the negotiation of the European Development Bank's articles of agreement, environment has been a key issue, an effort has been made to craft a bank which will promote the transition to market-oriented economies. This effort is being pursued in a number of different ways including a provision which will require the bank to make 60 percent of its loans available to private sector organizations or to state-owned enterprises that are privatizing to private control. No other MDB has such a provision today, for example. It is very much on the minds of the creators of the bank, to strengthen the private economy and in doing so to make certain that there is ample provision for environmental considerations.

On the other side of the Bank's lending or projected lending plan, namely to governments and government-owned organizations again, there is specific provision being made for environmental loans. Of course the board will have to work out how that is actually done, but environmental considerations have been included in the articles of agreement so far negotiated.

Mr. **Porter**. Thank you.

TURKISH TROOPS IN CYPRUS

Secretary Wolfowitz, what do you estimate that the Turks spend every year to keep their army on Cyprus?

Mr. **Wolfowitz**. I do not have an exact number, Congressman. It is a very small amount.

Mr. **Porter**. How many troops do they have there?

Mr. **Wolfowitz**. They have about 30,000, I believe, but they have very minimal equipment, and Turkish soldiers are paid minimally. It is not a significant part of their defense budget.

Mr. **Porter**. What do you think the Turks would do if we adopted a suggestion by my colleague from New York, Mr. Mrazek, that we cut their aid by $100 million and then refund it in $5 million increments for every 1,000 troops that they remove from Cyprus?

Mr. **Wolfowitz**. I think they showed what they would do Congressman Porter, by what they did when we had a similar situation with the arms embargo back in 1974. They would do absolutely nothing, and it would help the situation in Cyprus not at all.

But I might defer to Ambassador Bartholomew on this.

Mr. **Porter**. We get a little frustrated with the fact that 16 years has passed without any progress, that the troops remain there, that Mr. Denktas walks out, in effect, on the negotiations. That I think President Vassiliou and the U.N. Secretary-General have really worked to try to put together and nothing happens. And it is a tragedy for the people of Cyprus that this island remains divided and part of it occupied by armed troops. It just has to—something has to give here.

Mr. Bartholomew.

Mr. **Bartholomew**. Yes, Congressman. I was the first of a line of people to serve as Cyprus coordinator, serving from 1981-1982. The position was established because the administration at that time thought that there should be a central focus—to our efforts to push that issue forward to conclusion.

We are very disappointed with the last round of talks that the Secretary held last month. That round ended without any progress, and now we hope to get those talks resumed, to get the communities back to the table under the Secretary-General's aegis. We are going to be working very hard to back his efforts in this regard.

The point is that the path to the solution to the Cyprus settlement is going to lie through inter-communal talks, through the two sides coming to terms with each other. Ideas of leveraging Turkey in whatever form have consistently shown themselves to be counterproductive in the past. Instead of encouraging the flexibility which is often the objective of such measures, they have had the reverse effect. I think we are much better served if we keep our main effort where it is right now, support the Secretary-General in his efforts to energize the talks again.

Mr. **Porter**. I might agree with that if we saw some progress. The difficulty is we see obstruction, and I think the Turks have to realize that the world situation has changed in regard to their strategic position and our strategic needs, and we would love to see some progress. Unfortunately there is no progress.

Mr. **Coleman** [presiding]. Thank you, Mr. Porter.

At this time we are going to have to recess for 20 minutes. We will resume the hearings in 20 minutes. There is a vote on the floor. Thank you very much.

[Recess.]

MILITARY ASSISTANCE REQUEST

Mr. **Obey** [presiding]. If we could come to order, please. Since the schedules are as disruptive in the other hearings as they are here, let me get to a few questions of my own.

Mr. Bartholomew, I am still a little troubled because I see a great deal of discussion and words that recognize the changes in the world, but the numbers do not seem to reflect that change.

I do not like to quote from a popular magazine, but Time Magazine on March 5th said, "Cuba is not the only Soviet client looking at cutbacks in military and economic aid. Across Asia, Africa and Latin America other regimes experience hard times."

Then they said in Ethiopia, "the last of several thousand Cuban soldiers have departed. More than one third of the 2,500 Soviet military and development advisors, and their dependents have pulled out, and it is rumored that East Germans who ran the government's intelligence network have also returned home."

On Vietnam, "The Soviet Foreign Ministry announced that Moscow was removing its MG 23s and TU-16 long-range bombers while Soviet Prime Minister Ryzhkov said that Soviet air strength at the base would be reduced to five planes."

The New York Times, March 6th headline, "Arabs fear end of Cold War means a loss of aid and allies. Militant nations like Syria, Southern Yemen, Algeria, Liberia and Libya are also feeling a sharp decline of support from the Soviet Union and Eastern Bloc."

Andrew Duncan of the London-based International Institute for Strategic Studies said that the number of Soviet military advisors stationed in Syria has dropped significantly since the winds of perestroika began to blow through Moscow. In its yearly publication of the military balance, the institute reported that the number of Soviet military advisors in Syria dropped from 4,000 in '88 to 3,000 last year. "We expect the figure will be further reduced by June," the article said.

If you take a further look at the Time Magazine article, one of the statements was as follows: "Now, all the rest of the world gasps with delight, checkbooks in hand at the political and economic changes sweeping the East Bloc. Soviet supported Third World countries see their interests being knocked further down the list of international priorities."

Then you have a high Soviet official who says, "The Third World suffers not so much from capitalism as from a lack of it." Fairly dramatic changes. And yet we see the Administration budget, still in the aid area, primarily focusing on increased military aid.

How on earth can I explain to a single constituent at any town meeting in my district why we should do this in the teeth of the collapse of the Warsaw Pact with the reduction in the thrust of Soviet efforts in these areas. Why on earth and how on earth can I possibly support the idea of increasing military assistance and a conversion of the remaining $400 million from loans to grants?

Mr. BARTHOLOMEW. Mr. Obey, I am delighted to serve as your advisor on how to talk to your constituents, because I think there are some very good answers. Here is what I would say to your constituent.

There have been changes, as you just outlined. I would disagree with your conclusions in some cases, such as where Syria is concerned. But I will come back to that.

With regard to the changes that you have talked about, I would say this to the constituent. Look at how we are proposing to spend the nation's money, and ask yourself whether those purposes make sense.

Number one, peace and stability in the Middle East, which is a major investment that we make.

Mr. Obey. Well, nobody is suggesting changes in the Middle East except the Republican floor leader in the Senate and the Administration, with respect to its request for flexibility. Nobody in the Congress is suggesting changes in the Middle East.

Mr. Bartholomew. I understand that. But this does relate to the question of the degree of change.

Mr. Obey. Pardon me, but that is a red herring you just dragged across the scene. Your budget does not provide an increase in military aid for the Middle East. And I am asking you why I should support increases in military aid?

Mr. Bartholomew. The increases in the military aid that we see are most evident in the areas of the programs that support the fragile democracies, such as the Philippines and El Salvador.

Let me back up and start with the question of increases, in military assistance first. I want to question the figures that I have heard you cite. I think you said there was a 62 percent increase in the security assistance account since 1981.

Mr. Obey. Since 1981.

Mr. Bartholomew. Right.

Well, I think you have to first look at it in this sense. While it is true that appropriations for the FMF account have increased from $3.2 billion to about $4.8 billion since 1981, those figures are not adjusted for inflation.

Mr. Obey. Yes, but we have had a 40 percent reduction in the purchasing power of the money that goes into domestic investment programs, too.

Mr. Bartholomew. Well, in terms of constant dollars, as we measure it, there has been a decline of 10 percent, Mr. Obey.

Mr. Obey. There has been a 40 percent decline in the purchasing power of domestic programs over that same period.

Mr. Bartholomew. Let me make three points as we look at the question of the military aid increase, from last year, Mr. Obey.

First of all, we calculate the increase, in the fiscal year 1991 military assistance request that we have before you, as $192 million, not $317 million that has been cited, over fiscal year 1990 actual appropriation.

Mr. Obey. Okay, so let us assume all the numbers are wrong. Let us assume all of my numbers are wrong. Why should we have one dime of an increase in military aid?

Mr. Bartholomew. We are asking for a 4 percent increase.

Mr. Obey. Why should we have any increase whatsoever, given the fact that our adversaries have essentially collapsed?

Mr. Bartholomew. Well, the purposes for which military aid is used remain valid. That military aid remains valid in terms of funding the President's war on drugs, for example.

Mr. Obey. Okay, why do you not take it from somewhere else? Do you just add on to the budget? The President is asking us to make all kinds of reductions on the domestic side of the ledger.

Mr. Bartholomew. Mr. Obey, we are adding in this area 4 percent over last year's actual appropriated figure, which was significantly below the request level.

Mr. Obey. This committee has always given you every dime you have asked for drugs, and more. We have never yet, since I have been Chairman, cut the Administration request for drug programs by a dime. In fact, on one occasion, we added money above the Administration request. Let me grant you that we ought to be spending more money for the drug initiative. My point is, instead of building on your old base, why do you not reduce military funding somewhere?

An example is base rights countries. Why on Earth do we have to continue to provide what is essentially a welfare program for the less wealthy European countries? You are asking for $1.1 billion this year for Portugal, Turkey and Greece? Where is the threat? Why should the Europeans not pick up that difference if they want to provide an economic helping hand to those countries?

Mr. **Bartholomew**. It is the strength of NATO, that has gotten us to where we are. We think that strength——

Mr. **Obey**. But when you cross the finish line, you quit running, do you not?

Mr. **Bartholomew**. We think that strength has to be maintained to get us over the finish line. We believe that the southern flank is important in this regard, both strategically and in terms of our bilateral connections.

Our relations with the countries on the southern flank of NATO are important not only in terms of their membership in the Alliance, but also in terms of our bilateral relationships. They have real military needs, that Paul Wolfowitz can speak to, which we think need to be sustained as it is at the levels that we are requesting.

We are not making them fat militarily, by simply maintaining modernization programs that we think are necessary to sustain their strength, Mr. Obey.

Mr. **Obey**. Well, let me this. You can always make the case for increasing military aid to anybody, because there is never a limit.

Mr. **Bartholomew**. Mr. Chairman, we did not do that. We asked for 4 percent more this year.

Mr. **Obey**. That is correct. And I am telling you that I think you ought to be asking for 20 percent less.

Mr. **Bartholomew**. As we examined the needs that were involved, we had to reject a strong case for 20 percent more military assistance, even though we saw what we thought were valid purposes for the Nation in this area.

AID REQUEST FOR EASTERN EUROPE

Mr. **Obey**. Considering the changes in the world, what are we providing in contrast to Eastern Europe? The Administration is asking for a $300 million appropriation for Eastern Europe this year, is that right?

Mr. **Bartholomew**. Yes, sir.

Mr. **Obey**. And how much did the Congress provide last year for Eastern Europe?

Mr. **Edelman**. The appropriation was around $281 million.

Mr. **Bartholomew**. Well, the SEED Act authorized $938 million, but that was over three years.

Mr. **Edelman**. The appropriation was about $281 million.

Mr. **Obey**. Plus credits of several hundred million?

Mr. **Edelman**. Yes. I am talking about the actual appropriation.

Mr. OBEY. What is the total magnitude of the amount of money that you are asking us to provide Europe in this bill this year—cash and credits?

Mr. EDELMAN. To provide Europe?

Mr. OBEY. Eastern Europe.

Mr. EDELMAN. I do not know the answer regarding credit. The appropriation request for FY 1991 is $300 million, Mr. Chairman. I do not know how much is in for OPIC or Eximm or other areas.

Mr. OBEY. Well, the Administration is requesting that we cut Exim this year.

My point is simply this. If you take into account the credits that we have provided, you are asking us to, if anything, provide less for Eastern Europe than we provided last year. In addition, we have got more countries to provide it to.

Mr. EDELMAN. Let me leave out the credits and compare the $281 million of fiscal year 1990 in appropriated funds, to the $300 million requested for FY 1991.

Mr. OBEY. All right, let us do that.

Mr. EDELMAN. The $281 million has in it $200 million in a stabilization fund for Poland, which we estimate to be a one-time shot. We do not need that again in 1991. Therefore we really should be comparing a level of $81 million versus the request for $300 million.

Mr. OBEY. Fine.

Mr. EDELMAN. Thus, there is a sizable increase for Eastern Europe for 1991 compared to 1990 in the appropriated funds.

Mr. OBEY. Well, fine. But you can define it almost any way you want. The fact is, in just straight numbers, your response to the collapse of Eastern Europe and the opportunities there is to provide $15 million more than the Congress provided last year. I mean, to me, that is little league stuff.

To have an initiative that small, given the needs there, and to continue to provide what I regard to be the bloated amount of money we are providing for military assistance, just is not responsive to the changing nature of either the threat or opportunities.

Can you tell us specifically how you intend to use that $300 million?

Mr. EDELMAN. Yes, I can give you the categories we intend to fund.

We do not have an exact dollar amount for the categories.

Mr. OBEY. Here is my point. We have gotten this feeling that the Administration wants a specific amount of money for Eastern Europe—$300 million—but we do not think you know quite how you want to spend it. Which leads me to think that the policy is number driven, rather than the number being policy driven.

My question is, why is $300 million the right number? You are asking that we eliminate all of the specific designations that we provided last year in the bill for Eastern Europe and to provide a more general authority, as I understand it. I am trying to figure out, if we do that, where is that money likely to go?

Mr. EDELMAN. About 10% of the money we plan to spend in FY 91 will be for various democratic initiatives. This includes assistence for post election activities, parliaments, and labor unions, etc. In addition, the Secretary of State, on his recent trip, talked about the media fund, which I think would be about $9 million for next year. There is also support for non-governmental organizations, the grassroots democratic initiative movement that is going on throughout Eastern Europe.

The next amount, about 20% of the fund, we are planning to spend in technical assistance, providing things like entrepreneurial training, provision of technical training, scholarships in management, accounting, banking, economics. Things that are needed not only to make the private sector work better, but also the governments to be able to respond to the needs of the private sectors, as well.

About another $30 million for environmental activities. The Secretary has talked about setting up an environmental center in Budapest. We are now engaged in working in——

Mr. OBEY. Do you have a rough idea of how much money you expect to provide to each country?

Mr. EDELMAN. No, sir, we do not have an idea of how much we are going to spend in each country. We have not yet seen how these countries are going to evolve and in what form. We still have elections to go and do not know what is going to happen with them.

DEMOCRACY PROGRAMS IN EASTERN EUROPE

Mr. OBEY. Well, let me ask you one question before I ask the other gentlemen for their questions, about money we have already appropriated.

Mr. EDELMAN. Yes.

Mr. OBEY. We provided authority for you to make available up to $10 million for promotion of democracy in Eastern Europe, in addition to the $4 million provided in the fiscal year 1990 bill.

A.I.D. recently notified this committee of its intention to proceed with funding for $6 million rather than $10 million. And apparently, as we understand it, Assistant Secretary Eagleburger made a commitment to Senator Helms that those funds would go through the National Endowment for Democracy. Is that correct?

Mr. EDELMAN. Yes.

Mr. OBEY. Well, I find that rather quaint. Why was that commitment made to Senator Helms when this is the committee that provides the money? This is the committee that initiated the proposal in the first place?

Mr. EDELMAN. As Mr. Eagleburger explained it to me, when he was trying to get the Panama supplemental legislation through for $42 million, the Senate, and Senator Helms specifically, wanted to make sure in the legislation that all of the money was for NED, but the House did not. Mr. Eagleburger felt it was expedient to agree in order to get the Panama legislation through.

Mr. OBEY. Well, how is he going to get it through this committee this year, since we have the jurisdiction over that baby?

Mr. EDELMAN. I cannot answer that. I am only trying to tell you what I understand to be the reason why he did what he did, as he explained it when he was before the House Foreign Affairs Committee recently.

I cannot discuss phase two of the problem.

Mr. OBEY. I find that very quaint. I also find it interesting that our committee had to find out about that agreement indirectly. We were not even notified directly about it.

In the past we have relied heavily on party institutes and the free trade union institute to implement a lot of those efforts. If the Administration wants to have continued cooperation with this committee, since we have the responsibility to provide funds, not Mr. Helms, then cooperative understandings need to be reached with this committee. I frankly, flat out disagree with the way in which this has been handled.

If one United States Senator can obstruct the judgment of the entire House of Representatives, we have got a big problem.

Mr. BARTHOLOMEW. Mr. Chairman, if I may. We understand what you are saying. We will work with you where this question is concerned.

Where the NED was concerned, the problem was partly the congressional situation that Mark Edelman described. In addition, quite frankly, there was a lack of clarity as to what the lines of responsibility in force were, and a sense that the NED was an available institution which has a pretty good track record in expending funds quickly and efficiently.

With the elections so close, it was thought that was a reasonable way to proceed.

We are also starting to utilize other institutes. I think AID has a contract with SUNY, the State University of New York, which relates to the support of the Hungarian legislature.

And as we move forward we will be expanding the group of grantees next year depending on the scope and timing of programs and the like. We will want to work with you on that, Mr. Chairman.

Mr. OBEY. My point is simply this. I noticed, for instance, that Freedom House alone is slated for $215,000 and may receive another $460,000 to administer the Civic Forum Program. As I understand it, that would mean that one organization is receiving more than either of the established party institutes. My question is why is NED getting away from its traditional approach of having the party institutes be responsible for party development?

In this country, if you wanted to help develop political expertise about party development as we are trying to do in Eastern Europe, you would not go to Common Cause or the League of Women Voters. You would go to the two parties.

Mr. EDELMAN. As I understand it more than 40 percent of the funds we are presently planning to give to NED under the Panama supplemental are going to the party institutes.

It is not that we are just going to write a check to NED—I have discussed this with Mr. Gershman. We are not going to give a grant to NED, and let them do their own thing. We are using them as the instermediary for other grantees we have been working with.

Mr. OBEY. Well, I think you have a little empire builder there who has a basic misunderstanding of what this committee is going to tolerate with respect to the distribution of those funds.

I have exceeded my time. I am sorry.

Mr. Coleman.

Mr. **Coleman**. I will yield to Mr. Mrazek.

SECOND INFANTRY DIVISION IN SOUTH KOREA

Mr. **Mrazek**. Thank you, Mr. Chairman. I appreciate the deference shown by my colleague, Mr. Coleman.

Secretary Wolfowitz, according to the Director of the Central Intelligence Agency, the Soviet military machine is disintegrating as we speak here today, and the Soviets have pulled most of their resources, at least the MIG-23s and the Badger bombers out of Cam Rahn Bay. Yet we are going to spend several billion dollars or more this year maintaining the Second Infantry Division in South Korea at a time when, as I understand it, there are more than 40 million South Koreans and only 20 million North Koreans.

Logic suggests that considering the tens of billions of dollars we have invested in training and supporting South Korea since 1954 that if they chose, they could put twice as many trained men in uniform as their neighbors to the north, no matter how irrational that state might be.

Why are we only understaking these cosmetic minimal reductions suggested by the Administration, which basically offset the manpower additions in the early 1980s? Why are we not removing the Second Infantry Division?

Mr. **Wolfowitz**. I would make three points. Number one, whatever disagreements or nuances there may be about what has changed in the Soviet threat, there is nobody arguing that the North Korean threat has changed at all, except upwards. It remains, along with Cuba, among the completely unreconstructed opponents of perestroika and glasnost. There is no change in the military threat.

Number two, what has changed significantly is the contribution of our South Korean allies, and we have been able to keep up with the greatly increasing North Korean threat largely because the South Koreans have greatly increased their military capability over the last ten years.

And finally, in terms of our presence there, while we see some room for efficiencies and for thinning out, the fundamental purpose for the Second Infantry Division's presence is deterrence, and it is to avoid repeating the mistake that we made in 1950, when Secretary Acheson declared that Korea was outside of our area of interest. Six months later North Korea invaded.

We are interested not in fighting a war successfully, but in deterring it, and we believe our presence in the Korean Peninsula is the best way to keep a war from happening.

Mr. **Mrazek**. History also suggests that there was some help for the North Koreans from another rather large nation in the region. It is my understanding, at least, that China and the Soviet Union are not real close allies or friends of North Korea any longer. Is that not true? Is China close to North Korea at this point?

Mr. **Wolfowitz**. Well, actually they are reasonably close, and they seem to have gotten closer, but I do not mean by that to suggest that the Chinese or the Soviets would welcome or support a North Korean attack.

But the point is that the North Koreans in 1950 initially went in on their own. It was only when they got in deep trouble that they got help from the Chinese. In fact, they almost conquered the entire Korean Peninsula on their own.

And you are talking about Kim Il Sung, an old man, a dangerous man, a man who has been willing to plant bombs in a foreign capital, to attempt to assassinate the president and cabinet of another country, to plant bombs in civilian airliners, and to build tunnels under the demilitarized zone.

We are talking about a very dangerous and unpredictable regime, and the savings are too small to justify the risks we would run that we might have to go back there once again with half a million troops and 50,000 lives lost.

Mr. **Mrazek**. Well, I would come back to the point that this is not 1950. South Korea now has seven times the gross national product of its neighbor to the north. It has one of the most dynamic economies in the world today. They have twice as many people as North Korea.

Do you not think it might be more in our interest to utilize that several billion dollars in facing up to new challenges to our national security?

Mr. **Wolfowitz**. We are not going to save several billion dollars.

Mr. **Mrazek**. I can tell you that for the cost of one year's deployment of the Second Infantry Division on the Korean Peninsula we could build a magnetic levitation train system that would go from Boston to Washington in an hour. For those of us who ride on the shuttle—and there are probably some people in this room—that sounds like a pretty good idea. It might help our economic security in the future a little more than keeping those troops on the Korean peninsula for what you call deterrence.

I would submit to you further that we could also provide deterrence by taking some right-wing members of this legislative body that we serve in and put them right on the parallel with North Korea. It could be a rotating group and if there was an invasion and those lives were sacrificed in the interest of our national security, certainly their colleagues in Congress would be jumping to the forefront to make sure that we were there with the first and the mostest.

Mr. **Wolfowitz**. I am sorry, Congressman. I do not think this is a matter for levity. We had a Task Force Smith that was up on the demilitarized zone in 1950, almost all of whose members were wiped out when the attack came. The kind of savings you are talking about do not come from bringing troops home from Korea. They come from dismantling those troops and demobilizing them and having no army at all, and that really would weaken deterrence.

The cost of maintaining troops in many places in East Asia is going down because our allies, including the Koreans, are increasingly paying a share of the cost of those troops.

And as I said before, the South Koreans are spending a great deal of their own money, and this amount is increasing as their defense budget increases. We do not want them to spend half of their gross national product on their defense the way the North Koreans do.

Mr. **Mrazek**. They love to have us there because they are destroying us in the international marketplace, and the idea of our wasting our resources in a deployment like that is something that works to their economic advantage. I think the American people are waking up to the fact that this is a long outmoded policy and one that ought to be changed far more than the cosmetic approaches that have been taken up until now.

TURKISH PRESENCE IN CYPRUS

I would like to move on since I have all of five minutes, and I have probably exhausted most of it with this harangue against you. I did want to talk about Cyprus for a few moments.

You know, it seems to me that we are willing to use leverage against a lot of nations, particularly nations that are major recipients of American foreign military and economic assistance. and yet we are unwilling to do that with respect to a 16-year illegal occupation of Cyprus by one of our allies, Turkey.

Now that both Perez de Cuellar and other independent objective observers suggest that Mr. Denktash is the problem, I am curious to know whether and when this administration is going to attempt to use some leverage, perhaps a reduction in assistance to Turkey based upon its lack of interest in moving forward toward constructive negotiations.

Mr. **Bartholomew**. Congressman, the starting point has to be that the assistance that we give Turkey is not given to build leverage. We give aid to Turkey because we think it is in our interest. We give it because we think it is getting us something of mutual interest in terms of Turkish strength and in terms of its strategic location and in terms of strength for all of NATO.

So the first problem that you face is this we do not think that we could reduce aid to Turkey without paying a price in terms of our own interest. It is not a free lever in that sense.

The second point is that if you are interested in influencing the Turkish government to use its influence in turn with the Turkish Cypriots (as well as using your influence with the Greek government, to influence the Greek Cypriot government), to fashion a settlement on the island, you must accept that leverage is costly and does not work. It is not the way to deal with this situation.

And I say that, by the way, not just as a spokesman for the administration on this, but also as somebody who has dealt with it personally and who considers the human and strategic issues as worth a special effort by the United States to try to help bring about a resolution.

This we have tried to do. We have the sense that it is going to come as all other resolutions do, only when both sides recognize that any other course is of less interest to them. That is what we are trying to push with the Secretary-General by trying to help him get them back to the table and using our own influence on all parties to try to get them to deal.

Mr. **Mrazek**. Well, the Secretary-General has worked exhaustively, as we all recognize, to try to find a just settlement to the illegal occupation of Cyprus, and it is very clear from the most recent round of discussions that Mr. Denktash has become a serious obstruction to finding that just settlement.

Now, it would seem to me that if nothing else, we should reduce that portion of Turkish aid that goes to support this military occupation, which is estimated to be up to a quarter of the amount that we send them. It certainly does not serve our national security interest when we send them weapons to help keep Turkey strong against other concerns that we have in the region, then they send weapons to Cyprus to continue an illegal military occupation.

And for whatever it is worth, I know that a number of us in Congress will be working hard to see that aid is reduced and maybe you can put that message across to the Turkish government. I am not suggesting it is a majority of members of Congress or even that substantial a number—but I think it is a growing number.

I think that the amount of aid that we provide to Turkey that permits them to continue the occupation of Cyprus, when they are part of the problem of finding a just settlement, the time is coming soon when we are going to reduce that aid.

Thank you, Mr. Chairman.

Mr. OBEY. Mr. Coleman.

REPROGRAMMING MILITARY FUNDS FOR PANAMA/NICARAGUA

Mr. COLEMAN. Thank you, Mr. Chairman.

I thought that I should point out I came a little late this morning to the hearing because of another hearing in military construction where we were discussing the very issue that I think will be before this subcommittee next week: the President's request for reprogramming for Central America, Panama and Nicaragua. The issue of the military construction money to be reprogrammed met, at least initially in that subcommittee, with near unanimous disapproval.

There were serious questions asked by many of the members. I would only suggest that for those members who serve on the Military Construction Subcommittee, they believe that this is not the proper place to find the funds.

Now, some will say that this is a result of base closures, and we should not say, as the President's message I think does, that these bases are on a candidate list and may be closed. I think it would be unwise to spend money there.

But I will tell you also that—and I forget the title—the First Assistant Deputy of the Secretary of Defense testified this morning that he wants to put base closures on a faster track, waive some of the requirements along the way in environmental and other areas. That met with stern opposition. They are related to this reprogramming issue.

I would appreciate very much your taking the message back that I think some meetings need to go on this. I understand the urgency, but hopefully Secretary Baker and Secretary Cheney can discuss this matter further.

I was also told by a member who serves on the Defense Subcommittee that they have some problems with some of the requests. I think it winds up with all of the process being slowed, and I would just say that perhaps some coordination is needed, and those meetings should include some of the leadership of the subcommittees.

As you can tell from where I sit I would not be in those meetings, and so I am not saying this to ingratiate myself in any way, shape or form. I would just say to you that these appear to be difficulties.

Mr. **Wolfowitz**. I will relay your message, Congressman Coleman. I know we are eager to get the economic assistance for Panama and Nicaragua moving. Mr. Diefenderfer, who is Mr. Darman's deputy and Sean O'Keefe, who is the DOD Comptroller, are empowered to represent us in negotiating a satisfactory settlement on how to get that money.

Mr. **Coleman**. Secretary Mulford's statement said some things that I happen to be in firm agreement with. I have said this to Secretary Baker when he testified—that discretion, the capability to use discretion in responding to economic problems makes us more effective, and I agree with that.

I think that we have to understand that we will always have difficulties in how we balance the role of the executive and the legislative branches, and that is the issue.

I hope that we are all attempting to address the need for coordination in the near term so we can solve these problems, and this includes the issues I just raised. I think that if we can do that, we can resolve these problems and, indeed, I hope we can afford you the flexibility to become more effective. I think that is important in the larger picture, but also in the smaller details.

A lot of us have said it is not the big issues that matter, it is the small ones. We find that true, I think, in everyday life, and I think certainly it can become even more important than it has been in the past. I would just make that statement out of a sense of what I heard when I walked back into the room after the vote.

MEXICO SCHOLARSHIP PROGRAM

Finally, I had a number of questions to ask, but I want to submit them for the record. There was some language I put into our report last year. I authored some language in last year's report on a bilateral scholarship program under A.I.D, particularly as it related to Mexico, and I have some questions on that. Perhaps we can have some discussion on that issue.

[The information follows:]

Question. Last year, I authored report language urging A.I.D. to develop in Mexico a program analogous to the Agency's Central American Peace Scholarships Program (CAPS). Please tell me what progress has been made in developing such a program, what difficulties there may be in working with the Government of Mexico toward establishing such a program (if any), and whether or not the Congress can anticipate a request for funds to operate such a program in Mexico in the FY 1992 budget submission.

A.I.D. Response. Mexico is one of several countries in the region designated an Advanced Developing Country (ADC). ADCs have graduated from traditional A.I.D. bilateral assistance program during the past 20 years. In August 1989, a training program specifically developed for ADCs was authorized. Under this training project, USAID/Mexico's program goal is to familiarize Mexican leaders with U.S. institutions, technologies, and products by establishing partnerships and interchanges in support of mutual commercial and development interests.

The USAID/Mexico ADC Training Program emphasizes specialized technological training in nine fields: 1) private sector enterprise, 2) population and family planning, 3) health and child survival, 4) education and training, 5) agriculture and rural development, 6) biological diversity and ecology, 7) drug abuse prevention and education, 8) AIDS, and 9) energy.

The CAPS programs in Central America emphasize technical training for leaders or potential leaders, complemented with "Experience America" and "Follow-On" components. In the same fashion, the USAID/Mexico ADC Program incorporates these features of the CAPS Program. In addition, the Mexico ADC Program encourages linkages between the U.S. and Mexican institutions. For example, selected faculty of the Monterrey Technological Institute and other Mexican universities will be placed in degree bearing graduate programs at the University of Texas at El Paso.

Approximately 582 Mexican Participants will be trained over the 5-year life of the project beginning in FY 1990. The vast majority of the beneficiaries trained will be from the private sector. 3.9 million dollars has been planned for the 5-year period, averaging $780,000 each year. There have been no difficulties with the Government of Mexico.

U.S. RESPONSE TO DEBT PROBLEMS IN LATIN AMERICA

Mr. Coleman. Let me ask one other question on Mexico and really on this hemisphere if I could.

In terms of programs that we have, for example, in Argentina or Brazil or Mexico, how much of a problem is the debt, the international debt of these nations? How much of a problem is it for our programs themselves? Are we able to get around them? Do we have a plan and do all of our plans anticipate the resolution of those debt problems or do we anticipate having to deal with debt reduction along the way?

That is for any one of you who might be interested in answering that question.

Mr. Mulford. I am not clear, Mr. Congressman, about what programs you are referring to in that question. Obviously the debt problem is a very severe problem for the major countries of Latin America, and we are hoping that those countries——

Mr. Coleman. Well, on any of our A.I.D. programs and projects in any of the countries in this hemisphere——

Mr. Edelman. We have very minor programs in the countries you just named, Mr. Coleman, Mexico, Brazil, and Argentina, and so we do not get involved in the economic development problems as we are trying to do through our programs in, for example, Bolivia or Ecuador.

Now, in those countries the debt is a major problem. We are involved with those issues through working with Treasury and other donors. The debt problem in Central and South America is probably the number one impediment to development in those countries.

Mr. Coleman. It affects Exim as well.

Mr. Edelman. It affects everything they do because the debt problem is so major. It is substantially different in Latin American than it is, say, in Africa. In Latin America it is predominantly commercial debt and in Africa it is official debt or debt owed to government. How you deal with commercial or official debt is quite different.

The responsibility for dealing with those debt problems in Central America and South America or Latin America rests more with Treasury and the commercial banks. We—even the U.S. government—do not have all that much authority, but it is a major problem to development in those countries.

A.I.D. APPROACH TO DEVELOPMENT

Mr. **Coleman**. I think that kind of goes to the question that I understood Chairman Obey asked upon the reconvening of this hearing, and that was a question that I asked Ambassador Woods last year. That was, how do we measure progress? We had seen a number of reports last year, that I took the time to read, that tried to measure progress in the developing countries to estimate whether certain nations to whom we provide assistance would be economically prepared to, as we call it, graduate. I think that is the term we used in some of the reports.

I think the real question that I had was, are we departing from the way we have done things in the past, or are we doing the same old things?

In other words, when I look at the numbers, and I think that was highlighted by Mr. Obey's questions, they seem very similar to last year's. I recall Ambassador Woods last year saying to us that we needed to do some rethinking on some of these ideas and some of these programs, and I would hate to let his legacy be that everybody forgets what someone says, when in fact I think they were fairly profound.

Mr. **Edelman**. I share with you 100 percent agreement on your last comment. We are changing how we are thinking about these problems. I think over the next year especially, Dr. Roske is going to pick up that approach and keep moving with it.

But how we have been changing, over the past few years especially, is with more attention in our bilateral programs to policies, and using the traditional development projects not so much as an end in themselves but as a lever to get policy changes.

How do they relate to policy changes? Using more of our resources in nonsector ways instead of using our resources for more traditional development programs, realizing that if the host government policies are not right most generally what we do is only making poverty temporarily more bearable, but not curing poverty.

It took the so-called Woods Report, really, which highlighted that, and trying to work more with the banks, with the other donors. That general line, the importance of policy reform, eight years ago, ten years ago, was pooh-poohed throughout the developing world and by all the other donors.

That is simply no longer the case. It has become common wisdom everywhere, by both the donors and by the recipient countries. What varies is the will to carry it out, the will to do something about it, and that is what we were using more and more of our funds for, for leverage.

Now that gets back to another point of why the Economic Support Funds in most cases are tied directly into reform. These funds are not for military purposes. They go into providing us additional leverage and resources to help policy reforms come about.

That is certainly true in Central America, it is true where we have used them in Africa, and it is true in Asia. Those funds also complement the development assistance funds for policy reform, which is becoming more and more the focus of what we are doing.

The next phase we are getting into is how does that link into trade, and how do we use our funds not so much to leverage for trade but creating the environment for more trade?

Again going back to the so-called Woods Report, it pointed out so much more can be done through the private sector than the public sector—through investment, through trade, through purchases, than can be done clearly by what A.I.D. is doing in a bilateral way.

What we do, the few billion dollars that we invest or we spend in these countries is a drop in the bucket compared to what even the U.S. private sector does in these countries.

REEXAMINATION OF BILATERAL AID

Mr. **Coleman**. Well, I do not want to make it sound like a drill or a directive that the Secretary of Defense or Commerce or Treasury or State would recommend or suggest, but I remember the first impression I got of the Woods Report—and I think it is a good thing to call it that, because I thought it was important—was that in reviewing the last 20 years, which I think he referred to a number of times in that report—he suggested very candidly that much of our bilateral aid program over that period of time had been less successful, of course, than we had wanted it to be, and than we had expected it to be.

It seems to me fairly important, and I am sure this has been repeated by many people in this audience who have been here a long time often enough to make it unnecessary, but the problem is "how quickly we forget"? I think we do, because we always have new people. There may be new people at this table ten or 20 years from now, and there will be new people at our table, but it seems to me it is not wrong for us to talk about where we are headed again.

What I am saying is, when I talk about the legacy of that report, I would hope that we are talking about those new directions. You referred to them a minute ago and I thought did so very eloquently.

It seems to me that it would be important to set forth our new directions about how it is that we are going to do better than we did in the last 20 years. That is the reason I asked the question about Third World debt, or the debt of developing countries. I should not call it Third World debt. I mean the debt of developing countries and advanced developing countries. There is a problem that the debt is creating for us as a nation.

It seems to me that we ought to really address that and how we are going to set about resolving that problem, and I would hope that you are doing that. Maybe you have got on-going reports. I would like to know about them.

Mr. **Edelman**. I agree with both the letter and the spirit of what you just said. We have been talking about how to reexamine what we are doing, not just in our bilateral relationships and the bilateral aid program, but even, how does it link better with trade, and how does it link better with debt relief?

We are making some progress, in working closer with Ex-Im or with OPIC than we were before, in a more cooperative manner, to link our resources together. Over the next few months we are going to be reviewing all of this.

At the same time, we need to review it, actually, in the context of what is happening in Eastern Europe. What does that mean? That we have to reflect and change. We are spending more time, more attention, looking more at the subject of this hearing, really, which is the whole spectrum of democracy, growth and pluralism.

We have a much better understanding than we did two or three years ago, Mr. Coleman, about the role—the relationship, really—of democracy and economics. Hernando de Soto—and if you have not read or are not familiar with him, I really would like to get you familiar with him—talks about the role of reform, economics, the informal sector and what that does for development.

He has caused a lot of change in thinking, not so much because his ideas are something new. It is more his bringing up something that is obvious that we have not really thought about. It is not a startling new theory. It is not a new theory that governments constrain private enterprise, for example, in Peru—let us say the taxicab drivers—but we need to be more aware of it.

We are starting to work with that focus more and say, how does that apply to other countries? It is not universally applicable, but in Africa and in Asia, in Southeast Asia, how does that fit?

I think that is why I agree with you that we have to look at what we are doing and get away from the conventional approaches somewhat of what are you doing in health, what are you doing in population, what are you doing in agriculture research?

What are you doing in the broader development area, what are the major constraints for development, and how does what A.I.D. is doing within the totality of U.S. Government resources, the whole function 150 account, fit with that, and then with the other donors? We have started doing that, and it is fun to do.

BRADY PLAN DEBT AGREEMENTS

Mr. COLEMAN. Secretary Mulford, let me ask you—in dealing with the Mexico debt issue, I would kind of like to hear your opinion as well.

We all agree that the Mexico debt transactions have been fairly complex and a number of my colleagues have said—or there was a feeling, at least, that the issues were complex. We have three test cases of the Brady Plan so far. Costa Rica was a success, the Philippines is not a success and the jury is still out on Mexico.

I do not know whether your analysis from your perspective would coincide with that view, or whether you think that oversimplifies everything. In the limited time we all seem to have maybe that is the only way to talk about them, but maybe it would be good if you were to let us hear your views.

Mr. MULFORD. Well, first of all may I just make one short remark on the question you raised a moment ago about reform. I would like to emphasize that the heart of the debt strategy for heavily indebted countries continues to be economic policy reform by those countries.

If those countries cannot introduce the kind of reforms that will lay a basis for sustained growth, there is not enough aid in the world—commercial bank money or any other kind of resource—that can cure the problem. They have to reform their economies in order to work their way out of it, and that is really the heart of the strategy. We spend a great deal of time on those issues at the Treasury and other parts of the U.S. Government and in the World Bank and in the IMF and other fora of that type.

With reference to your question about the three agreements that have been reached so far, my opinion is that each country is different. Its economic situation is different, as is the size of its debt in relation to its GNP, its capacity to carry it, or its capacity to finance the debt by virtue of its foreign exchange earnings and the relationship between, for example, debt service and foreign exchange earning capability. Each country is different.

Therefore, I think one needs to judge each of those agreements differently. In the case of Mexico, I personally believe that Mexico was a very great success, and if you would like the ABC of that I would be happy to produce that for you in a letter or another form, or I could go over it here. I think that is a major success.

In the case of the Philippines I think it is a success. I do not rank it relatively as high as I would the Mexican success, because there was not as strong an element of debt reduction and debt service reduction in that deal, but it was still a very significant deal.

Thirdly, in the case of Costa Rica, I think that agreement was an enormous success. This was possible partly because Costa Rica has a relatively small economy and there were features of their problem; that made that high level of success possible in a way that I do not think would be feasible for a very large country with a larger economy and a different debt profile.

Mr. COLEMAN. Thank you very much for your answers. Thank you, Mr. Chairman.

Mr. OBEY. Thank you. Mr. Lehman.

Mr. LEHMAN. Thank you, Mr. Chairman, and I am especially happy to be here with Paul Wolfowitz. He was most helpful when I was on a trip to Indonesia. We learned a lot, and you did a super job there. You did so well that you came back here. [Laughter.]

U.S. BUSINESS DELEGATIONS TO EASTERN EUROPE

I just have a couple of general questions.

The Greater Miami Chamber of Commerce is sending two delegations to Eastern Europe to see if they can do something in regard to that area, not only economic benefit to help the free economies there, but also of benefit to our own economy in South Florida.

What have you been doing, and what could you tell me that I should pass on to the Miami Chamber people before these trips take place that would be helpful not only to our country but to Eastern Europe? This is kind of an umbrella question.

Mr. EDELMAN. Let me say just a few things. One, they should be sure to get in contact with the Department of Commerce before they go, because they are trying to organize some of these efforts.

Secondly, I would suggest they contact—and you might want to contact—Ambassador Zito, who is the head of OPIC. He has led several delegations over there already, including an investment mission to Eastern Europe, and he probably has more on-the-spot ideas than we do.

What A.I.D. is doing mostly in this case, though, is training as opposed to helping U.S. businessmen go over and invest. Which countries are they going to, Mr. Lehman?

Mr. **Lehman**. I think they are going to Czechoslovakia, Poland and Hungary, and probably East Germany.

Mr. **Edelman**. I think I would let my suggestions stand of who would be the best people to contact.

Mr. **Lehman**. I can give you the name of the person who is leading the delegation from Miami, and I will just have him—who should he contact in the Commerce Department?

Mr. **Edelman**. The best person probably to contact in the Commerce Department would be the Under Secretary for International Affairs, Mike Ferrin. We can let you know, though, exactly who is coordinating those efforts, if you would like, this afternoon.

SOVIET REFUGEES

Mr. **Lehman**. I am not asking for responses, but I think one of the major concerns we have to deal with is the situation with the Soviet refugees and how we are going to handle that, and that is going to take some money and some guarantees. We hope the Administration will be forthcoming in dealing with this problem, we have used the Jackson-Vanick amendment to force these issues and other efforts to force these issues, and now we are being overcome by our own success.

U.S. ECONOMIC STRENGTH

The other comment I would like to make is where we stand nationally and what we can do to help ourselves. We came out of World War I relatively stronger in relation to other countries than we went into it. The same thing happened after World War II. We won the cold war, but we did not come out of the cold war relative to other countries with the same economic strength in which we entered that cold war compared to other countries.

Ironically, I was told—and maybe it is not true—that the Australian Ambassador to Washington recently did such a good job that he was promoted to the Australian Embassy to Japan, so we are no longer the center of the economic world, and I would like to see us work our way back there.

Thank you.

POLAND DEBT RELIEF

Mr. **Obey**. Mr. Mulford, let me ask you about Poland. We have talked about this before, and we talked about it with Secretary Brady yesterday.

As you know, there have been a number of concerns expressed by many people about the fact that Poland has a huge amount of debt, which clearly is not collectable. These concerns are that debt overhang is going to prevent the Polish Government from being able to obtain the kind of investment that is needed to give them a decent opportunity to succeed.

In my view, there is nothing more important in Eastern Europe than the success of Polish reforms. If they do not succeed, I think that tells the Soviet Union that they should not go down the road to reform. That makes any progress in the Soviet Union much more difficult.

Jeff Sachs suggested an act of wise statesmanship would be to induce the Germans, since they hold most of the uncollectible debt, to provide major debt relief to the Poles. The United States provided major debt relief in this way to Germany in the early '50s, recognizing that was necessary to jump-start their economy. Is Mr. Sachs correct?

Mr. MULFORD. Well, I think, first of all, I would like to say that I think your point about the burden of the debt is a very important one for Poland, and the question is, as you put it, how do the reforms that the Polish Government makes—and we hope they continue to make them and they are successful—how do they actually work out in the end if the burden of the debt is too great to be borne over time? That is very much on our mind, so we are on the ground there.

If you look at the profile of that debt, which totals about $40 billion, $9 billion is commercial bank debt and about $25 billion is official debt. In the case of commercial bank debt, the commercial banks are now in conversations with the Polish Government, and we hope that in negotiating an arrangement they will give thought to including some degree of debt reduction and debt service reduction on their portion of the debt.

The governments have so far met—the creditor governments—and have given Poland a very liberal Paris Club rescheduling on about $9 billion of debt, and in effect what has happened is the burden of payment on Poland has been put off, now, until March of 1991.

That gives us all—and by "us" I mean the United States, Germany and all the other creditor governments—an opportunity to assess the situation on official debt and to work with the Poles first in their economy and secondly on financing their needs.

A very considerable amount of finance has been provided so far for Poland to try to address the long-term need, because at this moment in time I think it is very hard to determine what the value is of Polish commercial or official debt.

Mr. OBEY. I do not know of anybody who thinks it has any value.

Mr. MULFORD. Well, I certainly think it does have a value, and the question is, how much?

I would hate to see somebody, including our government, make a mistake of involving themselves in debt forgiveness on assets of the United States Government and people that prove in fact to be more valuable than they might have appeared to be a year ago or today.

But let me just make one last point, Mr. Chairman, and that is that I do not think you can address the Polish official debt question in a vacuum restricted only to Poland. I think it is part of the broad, official debt picture the United States has with countries all over the world, large debtors—other countries in Eastern Europe, Latin America, Africa. This is a very comprehensive problem, and I think that a sensible solution to the problem has to be found on a broader basis than a single country example.

So I think the answer is that Poland needs to be looked at over the next months, and it needs to be looked at in and of itself, but also in the context of the broader official debt problem.

Mr. OBEY. Well, I would simply say that I know every time the Polish issue is raised we always get back to the question of what is it going to mean with respect to Latin America? We do not want to send the wrong signals down there—Argentina, Brazil and the others.

I agree with that, and think we want to differentiate. We have to be able to differentiate intelligently. We have had two very special cases in the world. The first special case was with a country that caused two world wars—Germany—and despite that fact they got very favorable consideration, after the Second World War, from us.

Now you have a totally different government. A totally different entity than you had when Poland was under the heel of Soviet domination. We cannot allow our justifiable concerns about other portions of the world to freeze us into a position where nothing much happens in Poland. I mean, you talk about Paris Club reschedulings. I mentioned yesterday, we have had 117 Paris Club reschedulings for 45 countries in the '80s alone.

What we have going here is an elaborate scam that pretends that much of this money is collectable when in fact it is not, and everybody knows it is not except the taxpayers.

We will miss a tremendous opportunity if we do not insist that as part of the price for establishing a new order in Europe, which includes a unified Germany. Germany ought to do for Poland what we did for Germany. We could follow suit to the extent we are able?

I am not suggesting that debt relief ought to be 100 percent. However, we certainly ought to get rid of that overhang. Unless we act very quickly, I do not think that is going to happen. I think the issue will just drag out for years.

Mr. MULFORD. Well, Mr. Chairman, I think the point you make has merit. I think that so far, on the official side, the Paris Club rescheduling that was done for Poland is the most liberal that has been done, so that is step one. It is very liberal treatment, and it buys some important time.

Mr. OBEY. I do not quarrel with it, but I just think that it is only a temporary expedient.

ACCOUNTING FOR DEBT REDUCTION IN THE BUDGET

Mr. MULFORD. We have another dimension to the problem, Mr. Chairman, which we can ask you to look at in particular, because it is the dimension which involves the treatment of the process within our government and within our budget process and appropriation process.

One of the complex parts of this whole thing is not only the matter of differentiation between countries, and that problem that I raised, but it is very unclear at this point exactly how, if there were any official debt reduction, it would be accommodated within our own process, and what value is presently given to these assets.

If there was a write-down of some kind, how would that be treated in the budget process? Would there have to be an appropriation, at what level would that be, and then how would that appropriation have to be dealt with within our current budget process?

Those problems have to be addressed, it seems to me, not only with Poland in mind but also in the context of the broader applicability of some of the things that we are thinking about and with a broader world problem in mind. This could cause a very substantial budget problem for us, and I think we both need to focus on that and spend some time on it.

Mr. OBEY. I understand that. But again, that brings up my frustration. It just boggles my mind that we are going to let the bean counters, who do the accounting under the Gramm-Rudman budget process, drive policy in this instance. It certainly ought to be the other way around.

I would hate to think that we are going to see accounting requirements drive policy rather than the reverse, just as I would hate to see a continued Alphonse and Gaston routine between the White House and Dan Rostenkowski on that latest trial balloon.

Sooner or later people have got to cut through this nonsense and say, "hey, this is a big apple. You are dealing with minutia. For God's sake, widen the scope."

Mr. MULFORD. Well, the best way for us would be to get together and get a hold of the bean counters, really. That would be a good approach, because I agree with you, once you get a hold of them, your problem is partly solved. But getting hold of them is another thing.

Mr. OBEY. The bean counters are not the problem, the gutless policymakers are. The gutless policymakers created the bean counting system in the first place, and as you know I led the opposition to that turkey.

AID LEVELS TO PORTUGAL, GREECE, AND TURKEY

Let me just ask a couple of questions on Portugal. Will the United States be offering to increase, decrease, or eliminate current aid levels in the future to Portugal, given the base rights considerations?

Mr. BARTHOLOMEW. Well, what we have done with Portugal this year is in fact to return it to fiscal year '90 request levels, which does mean an increase over the fiscal year——

Mr. OBEY. But in future negotiations?

Mr. BARTHOLOMEW. In future negotiations I do not think we will see the question of security assistance levels as tied directly to the future negotiations in the sense of driving that level up.

The level that we have set security assistance at right now is keyed particularly to the F-16 program in Portugal, which extends out over the next four or five years.

My hope would be that we could hold constant at this, and looking to the out-years where Portugal is concerned, that is to say beyond the next four or five years, we can begin to move toward graduating Portugal from security assistance as we have Korea and Spain.

Mr. OBEY. What about Greece? Will the U.S. position be to continue existing aid levels in Greece, increase, decrease or eliminate? What are we going to do?

Mr. BARTHOLOMEW. Well, in fact, in terms of the policy where we are now, we have again continued that in terms of what last year's levels were. That is, as you know, Mr. Chairman, connected in some senses to the realities that imposed themselves each year in terms of the connection between Greece and Turkey, a connection that is set up here, one which we have argued against in the past.

Mr. OBEY. Since you are asking for a $1.1 billion appropriation for Greece, Turkey, and Portugal for base rights, it seems to me the best way to deal with that linkage is to cut them both.

I personally think we ought to come out of the appropriation this year with a reduced level of funding for Portugal, Greece and Turkey. This will send a clear signal that given the differences in threat assessment in that part of the world, which even the CIA chief agrees with, we ought to put that funding on a five-year glide path down to zero.

That is the best opportunity we have to make some real savings, so we can do more than tokenism in areas like Eastern Europe and other areas that desperately need some attention.

Mr. BARTHOLOMEW. I can understand that, Mr. Chairman, but the problem that we face as we look at it is that when measured against their needs, measured against what their own requirements are and the requirements that we think serve NATO's interest and our own, then the contributions that we are making to modernization are not overwhelming.

The kind of strength that we are talking about trying to keep in those countries is valuable for us and for NATO over the long term. What is happening in the strategic connection does not translate immediately into heavy cuts where these programs are concerned, in our view.

Mr. OBEY. Well, I think our aid to these three countries ought to be based upon what we think these countries need economically and militarily. It should not be based in any way on a commitment to base rights. With all due respect to that argument, if Portugal, Greece and Turkey do not think that those bases serve their interests as much as ours, then we should not have those bases there.

I am tired of seeing us held up by blackmail artists, to be blunt about it, who think they can use the world condition to have us finance a welfare program for low-income European states. That is really what is going on.

Mr. BARTHOLOMEW. Mr. Chairman, I am fundamentally sympathetic with the notion that this government should not be in the position of renting real estate around the world. I do not construe what we do in the southern flank, where those facilities are concerned, in those terms.

Mr. OBEY. Well, they sure do.

Mr. BARTHOLOMEW. Some of them do. Some of our own people do, Mr. Chairman. I am not saying that some of our own officials do not have a tendency to talk in those terms.

But what we are talking about maintaining with these countries is an overall defense relationship that has different components to it. In each of the components we think there is a mutual interest. For example, to take Turkey, we think a strong Turkey militarily is in our interest, and that in itself, there is——

Mr. OBEY. Are you really suggesting to me that with what is happening in the Soviet Union, the military threat to Greece, Turkey, and Portugal is greater than it was one year or two years ago?

Mr. **Bartholomew**. I do not say that.

Mr. **Obey**. But you would provide a budget increase for them.

Mr. **Bartholomew**. The budget increase that we provided is related to last year's fiscal year '90 request. It is designed to get up to a level that we thought was necessary in terms of program commitments.

Mr. **Obey**. Your increase for Turkey, Portugal and the Philippines is about $270 million. That increase is almost as much as you are committing in total for Poland, Hungary, Czechoslovakia, Rumania, Hungary, Bulgaria and Yugoslavia.

I just do not think that makes any sense given the way the world is changing.

Mr. **Bartholomew**. Well, I think that the increases that I have are less than that.

Mr. **Obey**. I am talking about the military and economic increases for those countries.

Mr. **Bartholomew**. I think those increases measured against allocations are, in fact, increases that take us back to fiscal year '90 request levels.

Mr. **Obey**. I understand. I have many wishes I did not get last year, also. I do not come in with that as my new base line this year.

Take a look around you. You guys have done pretty well over the last decade in comparison with everything else, but let us just agree to disagree.

U.S. AID AND POLICIES IN AFGHANISTAN

We are running late. Let me just ask two questions before we close on Afghanistan. Frankly, I am not at all sure what we can expect to see happen in that situation. On the surface it appears that our policy in Afghanistan is meant to promote democracy, and I am sure it is. But the reality of it looks much like chaos to me because of the historic inability of the muj to unite, and what appears to be the existence of a separate agenda on the part of the Pakistani ISI officials.

What can you tell us about that coup attempt and the role of the Pakistani ISI operation?

Mr. **Bartholomew**. The coup was led by the Minister of Defense and is the fourth and the most violent of such plot. It appears to have been rooted in intra-party differences. I think fundamentally what it highlights, Mr. Chairman, is the deep divisions that hold for the Kabul regime. That seems to me to be the central theme, its lack of legitimacy, and I think that that is the central factor to be highlighted.

Mr. **Obey**. Well, what about the Hekmatyar group which apparently was in alliance with people staging that coup? To what extent do he and his forces still receive U.S. bilateral and covert assistance?

Mr. **Bartholomew**. Well, Mr. Chairman, you understand that we are getting into matters that—particularly when you referred to the covert——

Mr. **Obey**. Well, what about bilateral?

Mr. **Bartholomew**. Mr. Chairman, I would prefer to talk to you privately on this matter.

Mr. **Obey**. On the bilateral? I mean, our A.I.D. bilateral program—the cross-border program?

Mr. **Edelman**. I do not know which groups are getting which food assistance programs, Mr. Chairman.

Mr. **Obey**. But he is still getting assistance from us, is he not?

Mr. **Edelman**. I do not know. I would be glad to furnish that information for you.

Mr. **Obey**. We do not know?

Mr. **Edelman**. No, I do not know. I am not saying we do not know.

Mr. **Obey**. Well, please get me that information.

[The information follows:]

The U.S. cross-border humanitarian assistance program is designed to provide assistance to needy Afghans who remain in Afghanistan. We do not provide assistance to individual leaders, but rather to parties and PVOs which are able to deliver that assistance inside Afghanistan.

Hezb-i-Islami (Hekmatyar) is one of the original seven Afghan parties which formed the resistance Alliance based in Pakistan. Hezb-i-Islami is among the better organized groups to meet the demands of needy Afghans for aid. In sum, we have channelled assistance to Hezb-i-Islami as a means to accomplish an end; meeting the humanitarian needs of war-affected Afghans.

Mr. **Obey**. What is our long-term program going to be in Afghanistan? Are we going to continue our bilateral aid efforts or should not the U.N. be picking up these programs?

Mr. **Edelman**. Well, at least for now we have been running that program at about $70 million a year for this year and for next year excluding food assistance. We are still planning to keep it at that level.

We also provide food aid assistance and support through the U.N. for these groups. A good deal of that aid goes through the Afghan interim government in trying to help them to provide health care, education, and agricultural inputs for the Afghanis inside Afghanistan and trying to help in essence look forward to the day when Afghanis can be back and controlling their own government. How long we should keep on this current path, is not a question I can answer right now, Mr. Chairman.

Mr. **Obey**. Well, the newspaper indicated that we had an $8 million covert program for the election. How is it that we can afford to spend $8 million for an election that is not going to happen in one country, and provide $6 million for elections in five or six countries in Eastern Europe that are going to happen? I mean, does that balance make any sense?

Mr. **Bartholomew**. Well, Mr. Chairman, if I may, in anything connected with it—and this is not to agree or disagree with what you are saying, but anything connected with covert programs obviously we cannot talk about publicly.

Mr. **Obey**. Well, it has already been talked about publicly. If you cannot talk about it, I certainly will. Again, we are just not moving off the dime. Inertia has this town by the throat as far as I am concerned, and I think this budget request reflects it.

CAMBODIA

I have a number of other questions on Cambodia which I will submit for the record.

[The information follows:]

Question. According to William Colby, who recently appeared before the Subcommittee, Cambodia ought to have elections supervised by the U.N. as soon as possible. He said, "The great powers ought to insist that an election be held there without waiting for an agreement among the constituted parties. These are all self-appointed representatives of the Cambodian people. It's time we got a representative of the Cambodian people. We have been diddling now, trying to get these four incompatible parties to work together, and they won't. There is no reason they should.

I think we should never help the Khmer Rouge to put their nose under the tent. Keep them out."

Mr. Colby went on to suggest that the UN Security Council could set up an election along the Namibia example. He further suggested having a wide open election with a lot of international observers to keep it honest.

What is the current U.S. policy toward Cambodia regarding negotiations?

State response. The objective of U.S. policy toward Cambodia remains a comprehensive political settlement which provides for:

International verification of the withdrawal of Vietnamese forces;

Measures to prevent the return to power of the Khmer Rouge; and,

Genuine self-determination through free and fair elections for the Cambodian people.

Our principal diplomatic efforts on Cambodia currently are directed to achieving a comprehensive political settlement of that tragic conflict, one which involves a significant role for the United Nations. To help this process, we and the other permanent members of the United Nations Security Council (the Soviet Union, China, Great Britain, and France) are working toward forging a consensus on a settlement structure which could then be recommended to the Cambodian factions.

While a number of difficult issues remain to be resolved, the first three Perm Five sessions have made considerable progress in outlining the role the United Nations would play in a settlement arrangement, including peacekeeping operations and direct administration of elections. We hope that these efforts and those of the regional states, particularly the ASEAN countries, will permit an early resumption of the Paris Conference on Cambodia, resulting in an agreement that will bring lasting peace to the Cambodian people.

Question. What do you think of Mr. Colby's suggestion?

State response. We do not agree with Mr. Colby's suggestion that UN-supervised elections be held in Cambodia even before an agreement is concluded. Under present conditions, we do not believe it would be possible to hold genuinely democratic elections in a secure atmosphere in Cambodia. More importantly, the results of any elections held outside the framework of a comprehensive settlement would in all likelihood not be accepted by all parties. The fighting, therefore, would almost certainly continue. If the decision in Cambodia is left to the battlefield, we believe, the ultimate winner would be the murderous Khmer Rouge, an unthinkable prospect.

Question. Why has the U.S. not pursued a more direct form of negotiations, namely direct talks with the Chinese and/or the Soviets?

State response. Our principal efforts on Cambodia at the moment are focused on consultations amongthe five permanent members of the Security Council, which of course include both the Chinese and the Soviets. We recognize that, given their relationships with the Phnom Penh regime and the Khmer Rouge respectively, Soviet and Chinese support would be key to the success of any settlement arrangement. As a result, Cambodia is a topic of discussion in practically every high-level contact we have with the Soviet and Chinese governments.

Question. How does the U.S. aid—$7 million to the Cambodian resistance respond to the changing events in that country?

State response. Our non-lethal assistance to the two Non-Communist resistance groups—Prince Sihanouk's ANS and Son Sann's KPNLF—is designed to maintain those groups as alternatives to the two communist factions. We, of course, provide no assistance to the Khmer Rouge. Without viable Non-Communist groups, the political fate of Cambodia would be left to a battlefield contest between the implacably hostile Khmer Rouge and the Phnom Penh regime. The outcome of such a struggle would likely favor the KR, an unthinkable prospect.

ASSISTANCE TO AFRICA

Mr. **Obey**. Let me simply say in closing that I agree with Mr. McHugh's expressed concern about Africa. They are getting short-sheeted and, in fact, they have some of the most monstrous problems of any continent in terms of absolute abject human misery, deprivation, and viciousness of governments.

Mr. **Edelman**. Can I address myself to that, Mr. Chairman?

Mr. **Obey**. Well, let me ask a specific question and then feel free. We are supposed to be promoting economic advancement, political stability, and expansion of freedom. How does the $53 million program in Zaire, $22 million in Malawi, and the $9 million program in Somalia coincide with those efforts? Those are pretty dismal operations as far as I am concerned. I mean, the governments are dismal operations.

Mr. **Edelman**. Let me back up if I can—and I am sorry Mr. McHugh is not here, but your question gets to the whole issue of who is doing what and who has what lead in what countries around the world.

Everyone, not the people in A.I.D. or the people in the Department of State, but on the Hill and in the press tend to view that the only aid that is going into these countries around the world is what the U.S. is doing.

In Africa the U.S. is far and away a tertiary donor. The French give three or four times what we do to Africa, and that is as it should be. They have the colonial interest, the old colonial ties. The systems are tied, in fact. If you look at the airlines from West Africa they all go back to the Metropole. In East Africa it is primarily the Brits who have the lead.

Even at $20 million or $30 million, for example, in Cameroon, where I served, as you know, we are about the fourth or fifth largest donor in that country.

When you turn to Central America, on the other hand, the rest of the world looks to the United States because of the same historic reasons, for good or ill, as being the lead in those countries.

AID PROGRAM IN ZAIRE

Mr. **Obey**. I will grant that as legitimate, but we have got a turkey running Zaire who has a personal fortune of $4 billion. He is the world's largest kleptomaniac.

Mr. **Edelman**. There might be others in the running, but I might agree with the general principle.

Mr. **Obey**. How much money are we providing that government in your budget request this year?

Mr. **Edelman**. If you have that number, it is probably correct. Your staff is as good as my staff.

Mr. **Obey**. Well, since this is your request, I want to hear you guys ask for it. I cannot believe you are asking for it—$53 million.

The reason I ask this question is I am having a meeting next week with the Black Caucus. They are coming and asking for a $1 billion increase for Africa. I am going to tell them that is unrealistic. The fact is that when we have those kinds of pressures, we have to, with the tremendous deficit facing us, squeeze out the marginal junk in this program. To me, money we provide to that fellow is marginal junk, to put it politely.

Mr. EDELMAN. The programs that we are doing in Zaire are——

Mr. OBEY. My point is that we are told we cannot provide debt relief to some of these countries because they do not have policy reform. Why do we not use that same principle with respect to our bilateral programs?

I mean, the President of Zaire could personally finance everything we are trying to do in that country with petty pocket change.

Mr. EDELMAN. The Government of Zaire was doing policy reform between 1983 and 1986, and it has begun again recently—our assistance levels to Zaire have fluctuated according to whether they are on or off the reform bandwagon.

The Government of Zaire at the moment is following an IMF program.

Mr. OBEY. Well, whether they are following an IMF program or not, the fact is the guy running the country has been stealing it blind. To the extent that we provide assistance to him, it seems to me we do not send the right message.

Mr. EDELMAN. But let me ask you a question, Mr. Chairman, on a point, if I even grant the point, which gets a little dicey. Let us assume that any head of state is stealing a country blind or in some other way oppressing their people. Do you not do programs still to try and help the people? It is a philosophical point.

Mr. OBEY. No, I do not think you should. I do not think you should in that instance. I think we know why we are providing aid to Zaire. It does not have anything to do with the welfare of the people in Zaire. It has a great deal to do with some people's goofy geopolitical views about how you deal with other questions in Africa.

Mr. EDELMAN. But, for example, in Zaire one of the projects in the North Shaba that we have recently completed helped increase the agricultural production, the production of maize, in the North Shaba province.

Should we not do that because the head of state may be one of the world's great kleptomaniacs?

Mr. OBEY. If I had my way, we would not be providing. The question is, given a world of scarce resources, what is the most effective use of resources consistent with our values and consistent with other pressures on us? I would suggest given the other problems in Africa, that money can be used just as effectively in some other country in Africa which is just as poor, just as desperate, and has as much need as the people in Zaire, thanks to the attitude of the turkey who runs the country.

We have extended beyond the time I had asked you to be here. I appreciate all of you coming, and want to reiterate just because I singled out Mr. Mulford earlier, that does not mean I do not have a high degree of respect for everybody else at the table. I do. We just have some different views about the content of the package.

[Questions and answers for the record follow:]

Questions for the Record From Mr. Obey

SUBMITTED TO DEPARTMENT OF STATE

AID REQUEST FOR EASTERN EUROPE

Question. Mr. Bartholomew, the amount requested for Eastern Europe—$300 million—is less than the amounts provided by Congress in FY 1990. Of the total $657 million provided last year by Congress for Poland and Hungary there was $292 million in real money programs, $240 million in loan guarantees and insurance programs, and $125 million in P.L. 480 programs.

Thus the $300 million request is therefore only slightly above the amount of real money provided in 1990, but it is intended for all countries of Eastern Europe not simply Poland and Hungary.

Congress in providing funds for Poland and Hungary last year specified small amounts for a host of programs including:

Farmer to farmer	$1.0
Agriculture activities	10.0
Technical training—private section	3.5
Educational exchange	5.0
Environmental projects	13.3
Enterprise Fund	50.0
Democracy programs	4.0
Peace Corps	2.0

The legislation recently submitted by the President proposes that all earmarks for these programs be broken, and that he be given complete discretion over the distribution of both the FY 1990 funds and the $300 million requested for FY 1991. In addition the $300 million request includes authority for the U.S. to participate in any multilateral institutions (presumably the Eastern new European bank) which support the goals of the legislation.

The legislation also provides open ended authority for provision of funds to any Eastern European country which the President determines is making significant progress toward achieving political, pluralism, economic reform, respect for human rights, and willingness to build a friendly relationship with the U.S.

What can you tell us today about specific programs you intend to carry out with this $300 million, and what specific earmarks or programs would you alter if given the authority to break FY 90 earmarks?

Answer. We do not have specific planning figures for assistance to each country because we do not believe it is possible to predict precisely how events will unfold in Eastern Europe over the next eighteen months. Accordingly, we must maintain flexibility in our use of appropriated funds. We will be consulting with Congress as we develop our programs for each country in the region.

We plan to tailor U.S. Government assistance to the specific needs of each country based on our judgements of positive steps toward four objectives: progress toward political reform, including free and fair elections; progress toward economic reform based on the emergence of a market-oriented economy; respect for internationally recognized human rights; and a willingness to build a friendly relationship with the United States.

With regard to earmarks, we have received a number of requests for short-term technical assistance and training to help address high-priority problems in key areas such as banking, finance, and privatization, and for assistance to numerous American institutions of higher education wishing to become involved in Poland and Hungary. However, only $2 million remains unearmarked in FY 1990, leaving no flexibility to respond to the above requests. Similarly, there is no room under the present earmarks to provide support for the work of U.S. private and voluntary agencies.

Question. Provide for the record a specific breakdown of how the $300 million requested for Eastern Europe will be distributed by program and by country.

Answer. We do not have specific planning figures for assistance to each country, because we do not believe it is possible to predict with any degree of confidence precisely how events will unfold in Eastern Europe over the next eighteen months. Accordingly, we must maintain flexibility in our use of appropriated funds. We will be consulting with Congress as we develop our programs for each country in the region.

We plan to tailor U.S. Government assistance to the specific needs of each country in the region based on our judgments of positive steps toward four objectives:

progress toward political reform, including free and fair elections; progress toward economic reform based on the emergence of a market-oriented economy; respect for internationally recognized human rights; and a willingness to build a friendly relationship with the United States.

Question. Another suggestion resulting from our recent Eastern European hearing was that so called Ministers' Fund ought to be created. This fund would be used to pay U.S. management/financial consultants to advise Eastern European governments and/or businesses. It would be a relatively cheap way of giving governments and businesses technical advice rapidly. There is certainly a need to create an environment which attracts private capital and a need for technical assistance to create a market economy. What is your view of this suggestion?

Answer. Creating an environment which attracts private capital and establishing a viable market economy are certainly central to the objectives of our economic assistance program. U.S. technical assistance and training to help both governments and private sector enterprises in Eastern Europe are and will remain a core part of our program. We are exploring different ways of providing this assistance. We need a mechanism which is flexible and allows for a timely response, and we will be exploring this suggestion to see if it is really the best way to run a program which is trying to stimulate free market enterprise.

EASTERN EUROPE: ENVIRONMENTAL PROGRAMS

Question. Eastern Europe as a region is an environmental disaster. What specifically will be done with the $300 million in terms of environmental programs? What role will EPA play in these programs?

Answer. The Administration firmly supports assistance to Eastern Europe to address the region's serious environmental problems. Environmental assistance is one of the four major categories of support for Eastern Europe proposed in the President's initiative and elaborated in Deputy Secretary of State Eagleburger's testimony before the House Foreign Affairs Committee on March 7, 1990. As part of the initiative, the Administration's plans include the funding of environmental projects in fiscal year 1991 consistent with the $40 million three-year authorization under the SEED Act of November 1989, which authorizes assistance to Hungary and Poland. As Deputy Secretary Eagleburger noted in his testimony, our project to establish the Regional Environmental Center in Budapest is part of this effort. EPA has played a leading role in this initiative, as well as in monitoring the air and improving water quality in Krakow.

The President's initiative also seeks authorization to extend assistance to the other countries of Eastern Europe making progress toward political and economic reform. As we continue consultations with the various countries of the region, we expect to gain a better understanding of additional and more specific environmental needs of these countries.

EASTERN EUROPE: ENTERPRISE FUNDS

Question. What is the status of the Enterprise Fund? How much of the $300 million is for the Enterprise Fund? Has the President appointed the board to date? Why has it taken four months to get organized on this effort when there is a crying need for its implementation? How much is included for Hungary in FY 1991?

Answer. Congress has authorized a total of $240 million for the Polish-American Enterprise Fund. Of this amount, $35 million is appropriated in FY 1990. Congress has authorized a total of $60 million for the Hungarian-American Enterprise Fund, with $5 million appropriated in FY 1990. We will be reviewing the operation and effectiveness of the Enterprise Funds before making a decision on FY 1991 levels for both the Hungarian-American and Polish-Amnerican Enterprise Funds.

The perception of undue delay in implementing this program is inaccurate. In fact, the process has moved relatively quickly, although there is always scope for improvement. The SEED Act, authorizing the establishment of the Funds, was only passed at the end of November 1989. By December, A.I.D. had already issued a Request for Proposals, inviting financial management firms to submit proposals for the daily operation of the Funds. In January the Funds were formerly incorporated in the District of Columbia. In February applications were received for the management of the Funds.

Finding Board members who combine business, banking, and financial skills with a knowledge of Eastern Europe has taken some time. Once a list of candidates was identified, it took additional time to review potential conflict of interest issues and other legal considerations. After consultation with the Congress, the President announced the names of the American members of the Boards of Directors in mid-

March and by the end of March the two Boards had met for the first time. A.I.D. expects to transfer FY 1990 funds to the Board in April and we hope that both Enterprise Funds will be operational by this spring.

Question. What role do the State Department and the Treasury Department plan to have in the country—specific investment decision-making process of the Enterprise Funds?

Answer. A.I.D. is authorized to provide the grant funding of the Enterprise Funds. The State Department and other government agencies are authorized to cooperate with the Funds in order to achieve the mutual purpose of supporting the development of the private sector in Poland and Hungary.

The U.S. Government's interaction with the Funds will, however, be limited to providing information and foreign policy guidance and will not include any direct involvement in the selection process for individual projects.

The Board of Directors will be responsible for establishing procedures and criteria for reviewing and approving applications. Day-to-day management of the Fund is expected to be provided by professional managers responsible for identifying and soliciting appropriate business investment opportunities and for reviewing details and financing requirements of proposed projects.

EASTERN EUROPE: POLISH STABILIZATION PROGRAM

Question. What is the status of Poland's economic stabilization program? Have donors other than the U.S. contributed and to what extent? How much of the $300 million is intended for additional balance of payments support to Poland?

Answer. To date, Poland's stabilization program has been very successful. Hyperinflation has been brought under control, with the inflation rate declining from 78 percent for the month of January to about 5 percent for the month of March. Poland is in the midst of a recession, with industrial production down sharply and unemployment on the rise.

The following countries have contributed to the stabilization program for Poland:

United States	$200,000,000
Germany	250,000,000
United Kingdom	100,000,000
Japan	150,0[illegible],000
France	100,000,000
Italy	100,000,000
Canada	25,000,000
Austria	20,000,000
Switzerland	30,000,000
Spain	14,000,000
Norway	7,000,000
Australia	1,000,000
Turkey	750,000

The United States has not provided Poland with any balance of payments assistance in this fiscal year, nor do we anticipate doing so in FY91.

BALTIC INDEPENDENCE

Question. Has the Administration decided how to respond if a Baltic attempt to secede is suppressed by military force? By non-military means, e.g., creating arbitrarily insurmountable constitutional obstacles to secession, arresting nationalist leaders, outlawing political organizations advocating overthrow (dissolution) of the Soviet Union, economic blockage, etc.?

Answer. The present situation in Estonia, Latvia, and Lithuania is especially delicate. The new government in Lithuania is attempting to engage the Soviet government in negotiations. Expected changes in Latvia and Estonia following recent elections are also likely to move the question of independence to the front of their current political agenda.

In view of the extreme sensitivity of this situation, it would serve no concerned party to elaborate on possible U.S. responses to hypothetical situations. The United States government is prepared to respond to the situation as it develops.

I can assure the committee that the U.S. remains firmly committed to Baltic self-determination, and we strongly encourage the peaceful resolution of the dispute between the Baltic States and the Soviet Union through negotiations.

U.S.-EUROPEAN COMMUNITY (EC) ISSUES

Question. Assess the probability that the EC 1992 program will result in new protectionist measures against the U.S. market. The EC appears now to accept that the eastern part of Germany, if unified with West Germany, would become a formal part of the European Community. What effect might this have on EC 1992?

Answer. Our assessment, based on the extensive framework of the 1992 program already outlined by adopted directives, is that there will be some protectionist measures, but, on the whole, the Single Market exercise will result in a more open and competitive situation for the U.S. The EC has formulated more than 271 of the 279 directives which make up the Single Market program. Of these, more than 144 have been adopted formally by the EC Council. A large portion of the measures provide for the removal of physical barriers to movement of goods or services and harmonization of technical standards. As a result, a U.S. product will need only conform to one standard or set of rules to have access to all twelve EC member states' markets. This in general will liberalize trade. However, because the choice of standards can increase or decrease market access for U.S. products, we are working to ensure that U.S. companies and standard setting bodies have a voice in determining the new EC-wide standards and certification process.

We have repeatedly voiced our strong objections to protectionist provisions in the Broadcasting and Utilities Directives (formerly referred to as Government Procurement—Excluded Sectors). A key test will come as member state implement the directives. We will be following closely member state implementation and are prepared to defend assertively U.S. interests whenever they are threatened. Timely and well directed intervention has proven effective in the 1992 process. Following a concerted U.S. compaign, the EC announced in March 1990 that U.S.-made Japanese nameplate cars would not be included in a transitional voluntary restraint agreement covering Japanese cars.

With regard to the effects of the unification of Germany, there is a consensus in the EC that the 1992 process will not be slowed down by the German situation, essentially because the major part of the work is already finished. A 1957 *Protocol on German internal trade and connected problems* to the Treaty of Rome states that intra-German trade is a part of internal German trade and "application of this Treaty in Germany requires no change in the treatment currently accorded this trade." Likewise, there is no distinction permitted under the Treaty among German nationals. However, in practice there are numerous issues involving sensitive areas, such as pricing of goods, regional assistance and the CAP, which must be resolved as part of the process by which the eastern part of Germany becomes a formal part of the EC. The EC must decide how to deal with these questions. The whole German issue is the subject of a special EC Summit meeting scheduled for April 28.

Question. What do you think of the argument that as EC states lower barriers among themselves and therefore make their domestic industries more vulnerable to competition from other member states, they will seek to throw up external barriers to non-EC trade? Would entry into the EC of East European nations, each having labor costs lower than those in current members states, provide a similar impetus to the erection of external trade barriers?

Answer. Although on the whole we believe that the framework for the single market is proving to be trade liberalizing, we are aware that the pressure to protect EC firms threatened by increased competition is likely to become stronger as the package of 1992 measures are implemented in the member states. This is one of the reasons the Administration has placed successful conclusion of the Uruguay Round at the top of our trade priorities. A successful Uruguay Round will strengthen the GATT system, making it more difficult for countries to backslide into more protectionist policies. We will also continue to use our well developed bilateral channels to raise any potential problem of this nature directly with the EC.

As it is unlikely that any central or Eastern European country will have sufficiently developed the market economy and democratic political system necessary to qualify for EC membership within the near term, we do not anticipate strong pressure to protect Eastern European production. The EC is considering offering association status to reforming European countries, but only after they have taken decisive steps toward creating systems based on political and economic liberties. The agreements are expected to contain provisions for trade, cooperation, technical assistance and financial support, joint projects, political dialogue and information and cultural exchanges. Such association status, however, would not necessarily be a step towards EC membership.

The EC response to the extraordinary changes in Eastern Europe has been extremely generous. EC members and entities contribute about 75% of all assistance pledged so far (around $11 billion). The EC has also agreed significantly to increase market access for Eastern European goods, including in sensitive sectors such as textiles and agricultural products. At this time, we do not expect increased EC access for Eastern European goods to displace U.S. exports, due to the limited range of Eastern European exports and quality control considerations. Should the situation change, we would use multilateral and bilateral channels to resolve any problems.

Question. How would you assess U.S. political relations with the European Community? Are you satisfied that the EC Commission has proved the best means for transferring food, medical and emergency assistance to Poland and Hungary by the group of 24 nations that have agreed to provide such assistance?

Answer. We are very pleased with the progress we have made to carry out the Secretary's suggestion in Berlin on December 12 that we enhance our dialogue with the EC. Working with the current Irish Presidency, we have institutionalized and augmented meetings which were once ad hoc in nature. The President will be meeting once each EC Presidency with the President of the European Council. Secretary Baker will meet twice a year with his EC-12 counterparts.

The Commission has done a good job as G-24 coordinator. We credit the EC with being a driving force behind the generosity of a number of the participants. The Commission's actions in removing many of the EC's trade barriers ahead of schedule, and in the face of member state opposition, is commendable. Increased market access is going to be a key factor in successful transition for these countries. We also believe that the G-24 can improve its coordination efforts. We have always thought that other institutions such as the IMF, OECD, and IBRD should use their expertise in helping the reforming countries make the transition to democratic market economies. Recently, the EC has moved to involve these and other institutions more closely in the coordination process. As the assistance process moves from the outline to the execution phase, we look for the G-24 to develop a clearer sense of priorities. We expect the EC will share our opinion on this.

Question. Officials from some EC states believe that the United States should provide more financial assistance to East European states undergoing reform in order to assure that these states are pulled out of the Soviet orbit and to asssure that German assistance—and influence—does not dominate in Eastern Europe. How do you respond to criticism that the Bush Administration is not providing enough financial assistance to Eastern Europe?

Answer. The U.S. has been the leading force behind Western support for Poland and Hungary and the other emerging democracies of Eastern Europe. We are working closely with the EC, other members of the G-24 and the recipient countries to fashion a comprehensive program which will support the efforts of these countries to transform their political and economic systems. This effort should not only be measured in terms of dollars and cents, but in terms of whether the help we provide can reinforce steps taken by the reforming countries of Eastern Europe. The Polish Stabilization Fund is an example of U.S.-led aid which has been extremely effective in helping the Polish Government control the value of its currency. We contributed $200 million in grant funds.

VIEWS ON COCOM

Question. Some COCOM (Coordinating Committee on Export Controls) members are chafing at U.S. efforts to keep the list of high technology goods sold to Eastern Europe and the USSR restricted. How different is the view of the Bush Administration on the COCOM list from that of most of the organization's other members? Do you think that some COCOM members may soon cease to coordinate technology sales with the United States?

Answer. All members believe that COCOM should continue to play a vital role in the protection of their mutual security. Similarly, all members agree that COCOM must adapt to the changing East-West environment. There are differing views on just how deeply and quickly the control lists should be cut, but no member believes its interests would be served by ceasing cooperation with COCOM.

At a special meeting of the COCOM Executive Committee in February, the U.S. presented interim proposals for immediate adaptation of COCOM. We proposed some decontrol to all proscribed countries and more preferential treatment for Eastern European countries that adopt safeguards against diversion of controlled technology.

TRADE AND TECHNOLOGY TRANSFER

Question. It is widely expected that Moscow's liberalized emigration policies will lead to a waiver of the Jackson-Vanik restrictions and granting of most-favored-nation (MFN) trade status to the Soviet Union. While this is an important step in normalizing U.S.-Soviet commercial relations, it is seen by specialists as more symbolic than substantive. Export controls on technology transfer are a more difficult matter.

Does the Administration plan to recommend substantially reducing such controls? If so, what will the new guidelines be?

Answer. The USSR continues to maintain formidable strategic military capabilities. The U.S. and its Allies deter the use of those capabilities largely through our own technologically superior capabilities. We must therefore continue to protect strategic technology.

However, U.S. competitiveness in high technology is also important to our national security and we have entered an era of improving East-West relations. Export controls must adapt to the new environment. COCOM controls should not become a barrier to legitimate commercial trade or hinder reform in the USSR or Eastern Europe. To guide in balancing legitimate national security concerns with support for reform and U.S. business interests, the President ordered a comprehensive review of COCOM policy. The review will give us a solid strategic basis for proposals to adapt COCOM controls for both the USSR and Eastern Europe. We expect there will be significant streamlining of the control lists for all proscribed countries, including the USSR.

Question. U.S. and COCOM export controls have traditionally been applied uniformly to the Soviet Union and its Warsaw Pact allies. Is that policy being reevaluated? In view of the changed political conditions in Eastern Europe, how is that policy likely to change?

Answer. The interim proposals presented by the U.S. to COCOM in February differentiated between the USSR and Eastern Europe. Our interim proposals suggested granting a presumption of approval to approximately China Green Line levels to Eastern European countries that adopt safeguards against diversion of controlled technology. We believed that the growing political and military independence of the Eastern European nations made differentiation strategically justified. Since these states have minimal military capabilities, our principal strategic concern is diversion to the USSR. We asserted that safeguard regimes, while not ironclad guarantees, could provide a necessary margin of comfort and leverage to allow the export of higher levels of controlled technology to Eastern Europe than the USSR.

Some of our COCOM allies question the feasibility and strategic rationale for differentiation. They are generally opposed to differentiation at the levels proposed by the U.S. in February. Our ultimate approach for differentiation will depend on the outcome of our comprehensive strategic review and further consultations with our COCOM Allies.

NATO AND GERMANY

Question. Is German unification possible with over 350,000 Soviet troops remaining on East German soil? With agreement at CFE sketched for reductions of U.S. and Soviet forces in the Central Zone down to 195,000 on each side, how many Soviet forces would remain in East Germany after the reductions?

Answer. The Federal Republic has indicated that it could accept, for a limited time, a residual Soviet troop presence in the eastern part of Germany after unification. This presence is likely to be well below 350,000. The FRG has made clear its view that a united Germany should remain a full member of NATO.

Under the manpower agreement reached at Ottawa, the Soviet Union could station up to 195,000 troops total in East Germany, Poland, Czechoslovakia and Hungary. Separately, Czechoslovakia and Hungary have concluded bilateral agreements with the Soviet Union that would remove all Soviet troops from those countries by July 1991. We could not predict how the 195,000 troops might be divided between Poland and East Germany in view of German unification. Clearly, however, there would have to be a significant cut from the current number in East Germany.

Question. For years the West German government has carped at limits on its sovereignty (NATO overflights, U.S. regulation of the storage of chemical and nuclear weapons on its territory, for example), but now Foreign Minister Hans-Dietrich Genscher has proposed that, after unification, neither NATO nor German troops not under NATO command be placed in the current territory of East Germany. Do you believe that such a self-imposed restriction on German sovereignty is acceptable to the German political community for the long term? Some West German officials, such as Defense Minister Gerhard Stoltenberg, have questioned Genscher's proposal. Do Stoltenberg and other conservative figures in the CDU/CSU (Christian Democratic Union/Christian Social Union) support Genscher fully on this issue?

Answer. The Federal German Government has made clear that it foresees special security arrangements for current GDR territory within a unified Germany. Chancellor Kohl stated that no NATO forces or installations should be extended to the present-day GDR. In a joint government statement, Foreign Minister Genscher and Defense Minister Stoltenberg said that this referred as well to Bundeswehr forces.

Question. How will the reunification of Germany affect such NATO doctrines as "forward defense" and "follow-on forces attack" (FOFA) if NATO forces can not be stationed on Germany's eastern border?

Answer. NATO is taking into account changes in the security landscape as it works to define its force posture in light of CFE and the new situation in Europe—especially a united Germany.

The agreed NATO doctrine of forward defense has had a very specific meaning in the context of a divided Germany and the threat of a short warning attack from the Warsaw Pact. Follow-on forces attack is a concept of military operations that has had a similar application with respect to the short-warning attack threat. We and our Allies may want to look at these concepts—as they relate to the context of a divided Germany and a divided Europe—with a view to aligning them with the new security situation in Central and Eastern Europe.

We must not confuse a specific NATO meaning for "forward defense" with the much broader concept of forward deployment of U.S. forces in Europe. As NATO adjusts its strategy to take account of the new security situation in Central and Eastern Europe, the forward deployment of U.S. forces will reamin essential to stability in Europe and elsewhere.

Question. Genscher now opposes modernization of short-range nuclear forces (SNF). The U.S. position remains that modernization must be considered in the Alliance in 1992, and the Bush Administration has asked for R&D funding for SNF in the newly submitted budget. Is modernization of SNF possible without German acquiescence? If modernization is not possible, and the United States finds by the mid-1990s that it must remove obsolescent SNF from Germany, how will the doctrine of "flexible response" be affected?

Answer. In general, I would note that NATO's Comprehensive Concept, endorsed at last spring's NATO Summit, reaffirms the principles underlying the strategy of deterrence—including flexible response—and states that their practical expression in terms of size, structure, and deployment of forces will continue to evolve in response to changing international circumstances.

Our strategy of flexible response is adaptable to new circumstances. Its purpose of deterring war is still valid. The appropriate mix and levels of conventional and nuclear forces needed to maintain deterrence can be adjusted to changes in the security environment brought on by CFE and Soviet withdrawals from Central and Eastern Europe.

I would also note that in the Comprehenisve Concept the Alliance agreed the question of introducing a Lance follow-on would be dealt with in 1992 in the light of overall security developments.

Question. Do you believe that a united Germany must remain in NATO?

Answer. Undoubtedly, yes. Our strong view—shared by the West German government—is that a united Germany should be a full member of NATO. Our other Allies share this view, as do other non-NATO countries, including Poland and Hungary.

Question. Do you foresee a greater deterrent role in Europe for French and British nuclear forces? The French have repeatedly approached the Thatcher government in the past two years to seek discussions of coordination of their nuclear forces, and Thatcher has rebuffed them. Do you think that, should SNF modernization be blocked, she will change her position?

Answer. I am not in a position to speculate about what the French and British may have said to each other on this score, or what they might or might not do in a hypothetical situation.

In general, I want to stress that, as the Alliance has said repeatedly, there is no substitute for the presence of U.S. forces—including nuclear forces—in Europe. We recognize, of course, that British and French nuclear forces also play a role in maintaining deterrence in Europe. As the military confrontation in Central Europe subsides, this role may increase. This is primarily a question for consultation within the Alliance.

FUTURE EUROPEAN POLITICAL/SECURITY ARCHITECTURE

Question. The Bush Administration believes that NATO should seek to play an increasing role in "political" affairs as military tensions in central Europe diminish. How would you respond to those who contend that the European Community or CSCE (Conference on Security and Cooperation in Europe) is better suited to manage East-West relations in an era in which political and economic issues may take supremacy over security issues? Do you envision a more important U.S. role in the EC or CSCE in the future?

Answer. Our links with the institutions which share responsibility for managing the various aspects of European political, economic, and security affairs are complementary, not mutually exclusive. As the Secretary indicated in his Berlin speech last December, NATO, the EC, and our participation in the CSCE process form the central elements of our approach to a changing Europe.

NATO since its founding has had a profoundly political role in fostering cooperation among the like-minded democracies of the West. As Warsaw Pact cohesion erodes and threats to security and stability may change, the political aspects of European security will receive new emphasis. NATO will enhance its political role in managing peace, including foreclosing a potential aggressor's military options by maintaining an effective deterrent capability. We also will work with the EC to achieve a significantly strengthened set of institutional and consultative links across-the political and economic spectrum.

The U.S. plays a leading role in CSCE, which, in addition to NATO, provides an important mechanism for continued North American engagement in Europe, for enhancing cooperation, and for lessening tension on the continent. We see CSCE's security basket as complementary to—not a replacement for—NATO. NATO can play a stabilizing role for all of Europe, particularly in a time of change.

GERMAN RENUNCIATION OF NUCLEAR, CHEMICAL AND BIOLOGICAL WEAPONS

Question. West Germany renounced the possession or control of nuclear, chemical, and biological weapons in the London-Paris Agreements of 1954. Do you expect German leaders to make a similar renunciation in the Two-plus-Four discussions? How could such a pledge be guaranteed? Will the Four discuss German troop levels?

Answer. German leaders have scrupulously abided by their commitment in the London/Paris agreements of 1954 not to manufacture on German territory any atomic, chemical, or biological weapons. In addition, as a party to the Nuclear Non-Proliferation Treaty, Germany has pledged that it will not seek to acquire nuclear weapons.

We have every reason to believe German leaders will continue to adhere to these commitments in the future. In a speech on German unification to the Western European Union (WEU) in Luxembourg March 23, West German Foreign Minister Genscher stated that Germans could make an important contribution to stability if both German states jointly reaffirm their renunciation of the manufacture and possession of nuclear, chemical and biological weapons.

German troop levels are not an appropriate subject for the Two-plus-Four. German conventional forces are being addressed in the wider context of the Vienna negotiations on Conventional Forces in Europe (CFE).

GERMANY—"TWO-PLUS-FOUR" TALKS

Question. West Germany, in the view of many observers, has proven itself to be a viable democracy and a loyal NATO ally. As a result, some West German officials believe that a meeting of the Four Powers to review or assess the two Germany's plans for unification is unwarranted. Elements of the German public and the German media have also been critical of the exercise of residual Allied rights. Do you see issues that may cause serious disagreement in the Two-plus-Four meeting? Are the "Four" in agreement on the main issues? The Soviets contend that unification must wait several years. What is the position of the U.S. government, and the French and British governments? Does the idea of the Two-plus-Four meeting—particularly if disagreements with the Germans develop—risk creating a political backlash in Germany against the United States?

Answer. The "Two-plus-Four" process is intended to resolve the various rights and responsibilities of the Four Powers in Germany and discuss the external issues involved with the process of German unification. The United States continued to maintain close contact with the other Allied Powers as well as the Federal Republic of Germany on the issues to be discussed at "Two-plus-Four." We have also discussed the issue of German unification with other countries who have interests which will be affected. Concerning the pace of unification, the United States has no timetable for this process.

The Federal German Government is a full participant in the "Two-plus-Four" process. German officials have expressed their appreciation for the understanding and support of the American people and the United States Government for unification, and we have seen no indication that this will change.

The first session of the "Two-plus-Four" was held on March 14 and we anticipate the next meeting will be held soon.

SOVIET TROOPS IN THE GDR

Question. Can reunification of the Germanys occur with Soviet troops in East Germany? Do you believe that the two Germanys will move towards economic reunification if Soviet forces remain in large numbers.

Answer. West German officials have stated that they are prepared to discuss transitional arrangements in which Soviet forces would remain in present-day GDR territory in a unified Germany until they can be withdrawn in an orderly fashion. Developments in the area of German economic unification are proceeding rapidly, and it appears that economic and monetary union wil be implemented by this summer. The presence of Soviet forces would not affect these arrangements.

SECURITY ASSISTANCE TO BASE RIGHTS COUNTRIES

Question. What is the *current* rationale for continuing to provide security assistance to Greece, Turkey, Portugal and the Philippines in light of the changed nature of the military threat on which their security assistance has been historically based? Isn't it time to shift our scarce foreign aid resources to economic assistance and development—given the needs of newly emerging democracies in Eastern Europe? If not, why not?

Answer. Greece, Turkey, Portugal and the Philippines all have legitimate defense requirements which current levels of U.S. security assistance are unable to cover adequately. These defense requirements remain valid even in the context of the Soveit Union's current posture. Turkey in particular is a relatively poor country which, in addition to its important NATO role, faces potential significant military threats from its southeastern neighbors. Both Turkey and the Philippines, another poor country, face active insurgencies. In addition, Greece, Turkey and Portugal continue to bear responsibilities for the NATO framework on which the U.S. will rely for dealing with changes in Eastern Europe.

While we agree that economic and developmental assistance should have a high priority for the U.S., even more so given events in Eastern Europe, we do not believe that this priority should be met by taking away from the legitimate, ongoing security assistance needs of our friends and allies.

Question. For years Congress has been admonished not to reduce aid levels to base rights countries because of U.S. commitments on best efforts pledges. In fact the Administration has ended up reducing amounts requested for base rights countries in the allocation process. Why should Congress not seek to reduce funds requested for base rights countries, given the apparent fact that there has been no change in Administration policy on de-linking foreign aid levels to base rights agreements, and no new Administration thinking on the threat of the Warsaw Pact?

Answer. A U.S. aid levels to key friends and allies such as Greece, Turkey, Portugal and the Philippines are an essential part of our overall defense cooperation with them and serve U.S. interests as well as theirs. Although in some cases a recipient's military assistance needs are outlined in a base rights accord, the U.S. has been careful to do no more than pledge its "best efforts"—subject to Congressional action and overall availability of funds—to seek assistance to strengthen their legitimate self-defense capabilities.

This year, due to the combination of continued budget constraints and extensive earmarking of security assistance accounts there were insufficient discretionary funds to meet fully our "best efforts" pledge levels for some countries. These funding shortfalls were not, however, the result of any reduction in these countries' defense needs or in our interests in strengthening them. Continuing U.S. commitment to a strong and unified NATO, as well as our ties to key strategic friends around the globe, will play a crucial role in ensuring a peaceful transition to a post-Cold War world.

Question. With a decreased requirement for U.S. military presence in Europe, can we expect, and will we demand, that the European NATO Allies maintain sufficient military forces to meet whatever prospective military threat may still exist? Will we insist that the European share of costs to maintain whatever military presence is deemed necessary for NATO ends will *increase*, so that we can reduce our share of this military burden? If not, why not?

Answer. The CFE Treaty currently under negotiation will result in a balance between East and the West in major equipment categories. Additionally, the current "harmonization" effort within NATO—planning cuts in forces to meet CFE-negotiated force levels—reflects our desire for the U.S. to take greater reductions in treaty limited equipment than our Allies would take. Our objective is to achieve a proportionately greater European role within the residual Alliance force structures, with the U.S. playing a relatively more pronounced reinforcement role. At the same time, it is clearly in our interest to maintain a significant U.S. military presence in Europe for the foreseeable future.

PHILIPPINES

Question. Mr. Secretary, update the Committee on the political situation in the Philippines, and on the status of the MAI.

Answer. President Aquino remains in firm control of the Philippine Government, although fugitive former military officers and their sympathizers have the potential to attempt another destabilizing incident. The Philippine Government has been asserting its authority. The measures it is taking to arrest ex-Governor Aguinaldo of Cagayan Province and its plans to try other coup attempt leaders have reinforced President Aquino's message of determination to bring rebels to justice. President Aquino has taken important, measured, steps to limit the economic disruption caused by the coup attempt, to bring new leadership into government, to improve intelligence gathering, and to hinder new coup plotting and logistics.

The MAI was launched in Tokyo in July, 1989, when 19 countries and seven international organizations pledged a total of $3.5 billion in assistance for the Philippines. The United States will provide $160 million in assistance under the MAI in FY 90 to support project preparation and preinvestment studies, improvements in management of natural resoruces and the environment, a development project on Mindanao, policy reforms, and a capital projects funding facility. The AID Mission in Manila has already obligated $11 million for project preparation and other activities and is preparing the other projects for funding.

The Administration is seeking $200 million for our contribution to the MAI in FY 91. Ongoing U.S. leadership in the MAI will be necessary to encourage other donors to continue their support. The success of the MAI in achieving its aim to support democracy by promoting self-sustaining growth and improved living conditions will be increasingly important as the Philippine Government deals with the difficult economic problems it faces.

Question. If there is another coup attempt and President Aquino again asks for U.S. military intervention would the Bush Administration commit U.S. forces? Would the Bush Administration commit them into a situation where they likely would have to engage in combat? To what lengths would the Administration be willing to go to keep Mrs. Aquino in power in the event of a coup attempt against her?

Answer. President Aquino's Government is in control in the Philippines, although we cannot rule out the possibility that fugitive coup plotters or discontented elements within the Philippine military could undertake another effort to destabilize the government. We have shown our strong commitment to the survival of Philippine democracy. It would not be productive to speculate on what actions we might take in the event of another coup attempt.

The coup attempts since 1986 should not obscure the solid accomplishments of the Aquino government, which include establishment of democratic institutions and civil liberties, a revitalized, market-oriented economy, and progress in combatting the Communist insurgency. The U.S. Government remains commited to doing all it can to assist the Philippine Government's efforts to address the legitimate needs and hopes of the Filipino people.

Question. During Secretary Cheney's recent visit to the Philippines, President Aquino refused to meet with him reportedly as a means of protesting the cut by the Administration of $96 million in its level of foreign aid during the current fiscal year. How does the Administration intend to respond to the Philippines on the question of the aid cut? Does the Administration feel legally obligated to restore the cut? Does the Philippine Government feel it is legally entitled to a specific level of foreign assistance from the United States? Is the Administration prepared to leave the Philippine bases rather than accept the demands of Philippine leaders to increase U.S. foreign assistance levels beyond what the U.S. government determines is appropriate?

Answer. We have a major economic and military assistance program for the Philippines, despite this year's reduction from requested levels. Total U.S. assistance to the Philippines, including $160 million for the first year of the Multilateral Assistance Initiative, rose by about $200 million in FY90 over the FY89 level at a time of overall decline in available resources. For FY91, we have requested more than $650 million in total assistance, including funding for the MAI.

The Administration is exploring ways in which we can be responsive to Philippine concerns on the assistance reduction and needs for additional help. But in this era of increased competition for assistance resources, there is no assurance that we will be able to do so. For example, we are looking at the possibility of providing excess defense articles as one means to help the Philippine military commensurate with the levels of assistance we sought for the Philippines in FY 90, recognizing that we would need legislative authority to accomplish this. We will also be exploring other avenues of assisting the Philippines.

The United States is not legally obligated to provide the level of assistance targeted in the best efforts letter made in connection with the 1988 Review of our basing agreement. It is clear from the letter itself that the provision of assistance is subject to the availability of funding, which can only be appropriated by the Congress. The letter is a policy commitment by the Administration to do what it can to provide the targeted levels of aid within overall budgetary constraints.

While the Philippine Government recognizes that the best efforts letter is not a legally binding obligation under international law, it regards the letter as an integral part of the Review agreement it accompanied, in which, from the Philippine Government's perspective, it made concessions to U.S. interests to secure a particular level of funding. Therefore, in the Philippine view, the reliability of the United States as a partner in negotiating and implementing security agreements is at stake, despite the form of the undertaking.

There will be no "hold-ups" or blackmail over the bases. We will be negotiating in good faith and as equals. We have made it clear to the Philippine Government that despite an especially difficult domestic budget situation, we have provided—and continue to provide—substantial resources to the Philippines. We believe that there is broad recognition in the Philippines of the value of our security ties, despite the budgetary limitations we face.

The U.S. military facilities serve the security interests of both our countries, and, indeed, of the other countries of the region. Alternatives to our Philippine facilities exists, but they would be less effective and more costly. For these reasons, the Administration is hopeful that we can reach a mutually satisfactory new agreement for continued U.S. access to these strategically important military facilities.

Question. Regarding the U.S. "best efforts" pledge to seek $960 million in aid for the two years embracing fiscal years 1990 and 1991, how do you define "best efforts"? How does the Philippine Government define it?

Answer. The United States is not legally obligated to provide the level of assistance targeted in best efforts letters made in connection with basing agreements. It is clear from the letters themselves that the provision of assistance is subject to the availability of funding, which can only be appropriated by the Congress. The letter is a policy commitment by the Administration to do what it can to provide the targeted levels of aid.

While the Government of the Philippines (GOP) recognizes that the best efforts letter is not a legally binding obligation under international law, the GOP regards the letter as an integral part of the 1988 Review agreement it accompanied, in which, from the GOP's perspective, it made concessions to U.S. interests to secure a particular level of funding. Therefore, in the GOP's view, the reliability of the United States as a partner in negotiating and implementing security agreements is at stake, despite the form of the undertaking.

Question. In view of the role of the Philippine Senate in ratifying any new agreement on use of Philippine military bases, how have the Senators reacted to the $96 million cut in bases-related aid for FY 1990?

Answer. The shortfall has become a major political issue in the Philippines which may complicate discussions on our future security relationship. We have explained to the GOP that our best efforts pledge was a pledge to seek a certain level of assistance from Congress, not a guarantee of the specified levels, as Filipinos generally consider it. However, several members of the Philippine Senate have suggested that the shortfall places in question the good faith of the United States in fulfilling our existing agreement and makes it difficult to consider concluding a new agreement with us. We are examining ways to address the shortfall.

Question. What did Mr. Gates of the National Security Council tell President Aquino during his recent visit to Manila in January? Did he or any other U.S. official recommend that she undertake specific policy changes? What was her reaction to the specific recommendations?

Answer. Mr. Gates went to Manila to reaffirm to President Aquino the continuing strong support of the U.S. Government for her government. He also wanted a first-hand assessment of conditions in the Phillippines and of how the United States could assist the Philippines. During his visit, he met with President Aquino and Secretary of National Defense Ramos and discussed with them steps they were taking to revitalize the government, improve civil-military relations, and attract foreign investment. The discussions were friendly and productive.

Question. What was President Aquino's purpose in cancelling her scheduled meeting with Defense Secretary Cheney? What are the implications of her action for the base negotiations?

Answer. Secretary Cheney visited the Philippines as part of regular bilateral consultations. His host was Philippine Secretary of National Defense General Ramos, who previously had been the guest of the U.S. Secretary of Defense in Washington.

Secretary Cheney expressed the view that relations between the Philippines and the United States are very close and indicated that we have the utmost respect and regard for President Aquino.

The talks between Secretary Cheney and Secretary Ramos were productive and has helped set the stage for negotiations on the future of U.S. military facilities in the Philippines that are expected to begin soon. We are optimistic that these talks will lead to a continuation of our mutually beneficial security relationship.

The Philippine Government is best qualified to address the question why President Aquino did see Secretary Cheney.

Question. What is the magnitude and emphasis of U.S. aid programs aimed at helping the Philippines privatize more of its government owned institutions?

Answer. AID has financed recent programs which support the Philippine Government's privatization effort. Privatization policy has been one element of the $218 million Support for Development Program. The $5 million Privatization I project also supports Government of the Philippines efforts in this area. AID is planning another project, Privatization II, for FY 1990 to be financed over its life at $25 million.

The Philippines also receives assistance for its privatization program from a number of organizations to which the U.S. contributes substantial financial and policy support. The World Bank is financing a policy reform program conditioned on progress in privatizing Philippine Government-owned or controlled corporations. This program is on track. The Asian Development Bank and International Finance Corporation also have financed appraisals and provided technical advice for companies to be privatized.

PHILIPPINE BASES

Question. What is your long-term view of the base agreement?

Answer. The U.S.-Philippine Military Bases Agreement (MBA) is part of the larger, longstanding mutual defense relationship we have with the Philippines, and reflects U.S. support for Philippine democracy and economic development. U.S. facilities in the Philippines also enhance regional stability and help to advance our interests in the economically dynamic Southeast Asian area.

Our long-term presence in the Philippines will be shaped by both Philippine concerns and U.S. security needs in the Asia-Pacific region. The MBA has evolved greatly since it entered into force in 1947, in response to changing U.S. and Philippine needs, and we expect it to continue to evolve. Change must be approached in a careful manner, in close consultation with the GOP, and with a view towards enhancing efficiency.

We would prefer to retain our facilities and basing rights in the Philippines. Negotiations for a new Military Bases Agreement will begin soon, and we believe that we will ultimately be able to conclude a mutually beneficial agreement.

Question. Does the U.S. need a continuing presence of this magnitude in the Pacific theater, given the decreasing threat?

Answer. A forward deployed U.S. military presence in the Western Pacific and the bases needed to support it remain essential to our national interests. Although the prospects for conflict with the Soviet Union appear to have diminished, positive developments in the security situation in Europe have not been matched in the Asia-Pacific region. Soviet military forces continue to grow more effective and more lethal. Regional powers, such as India or China, continue to grow in military strength. Regional tensions with the potential to erupt into armed conflict, the most serious of which exists on the Korean peninsula, remain of great concern.

While the changing security situation in Asia has lagged behind Europe, our interests there continue to grow. The most visible sign of this is that Asia is now our largest trading partner. The increase in our economic and political ties to the region make retaining a U.S. military presence in the Asia-Pacific theater vital. Turmoil or conflict in Asia could have disruptive effects for the United States. Our military presence acts to deter conflict and enhance stability, and helps maintain a friendly political and economic environment for U.S. interests. The level of that presence can be adjusted as required for greater efficiency, but the need for forward deployed forces and the facilities to support them will remain.

Question. What specificially has the U.S. offered to Palau in the way of aid in exchange for use of their land for bases? Why have we offered them anything?

Answer. Under terms of the 1947 UN Trusteeship Agreement by which the U.S. administers Palau, the U.S. is obliged to promote self-government of independence, "as may be appropriate," as well as the economic, social and educational advancement of the inhabitants. Negotiations on the future political status of Palau, initiated in 1969, culminated in a Compact of Free Association which has been enacted into law by Congress (P.L. 99-658 and P.L. 101-219). Although seven separate plebiscites on the Compact have been held in Palau since 1983, none have achieved the 75 percent approval required by Palau's constitution. Thus Palau remains in trusteeship status pending adoption of a constitutional amendment to allow the Compact to pass by a simple majority, or, in lieu thereof, some other act of self-determination. Under the terms of the legislation enacted by Congress to implement the Compact of Free Association, Palau would receive from the U.S. approximately $460 million, adjusted for inflation. This would be given to Palau over a period of 15 years to promote self sufficiency (e.g. health programs, communications, economic development, etc).

With respect to defense rights, the 1947 Trusteeship Agreement, which remains in force, gives the U.S. unrestricted access the Palau. the U.S. is entitled "to establish naval, military and air bases and to erect fortifications in the trust territory; (and) to station and employ armed forces in the territory." The U.S. has never exercised these long-standing rights. Were we to do so, however, Palau would receive no special compensation.

Under provisions of the new Compact, the U.S. continues to be responsible for Palau's defense and security. In order to carry out these responsibilities, the U.S. retains specific access rights to the major harbor and airfield in Palau, and general access rights to other potential defense sites, subject to consultation with Palau, for a period of 50 years following implementation of the Compact. These defense rights granted by Palau were a factor in setting the compensation to be provided by the U.S. Government to Palau in the form of grants and other assistance under the terms of the Compact. However, the Compact does not specify the proportion derived from defense rights and is thus indivisible from the aggregate funds provided for all general purposes pursuant to the negotiated termination of trusteeship status. The decision to include the defense provisions in the Compact reflects an assessment of the geostrategic importance of Palau and its relationship to U.S. national security interests during the period of Compact negotiation. The legislative record of the Compact reflects Congressional affirmation of this strategic assessment.

Although the U.S. retains access rights in Palau, under both the Trusteeship Agreement and the pending Compact, there are no present plans to exercise them.

Question. If the Administration seek a renewal of base rights after 1991, are you willing to accept the Philippine argument that there is a direct linkage of base rights for the U.S. in return for specified levels of military and economic aid?

Answer. The U.S. position has been that the provisions of security assistance on our part and the provision of bases on the host country's part are mutual contributions to the common defense. We do not pay rent for bases. Efforts to link bases to assistance levels assume that the only benefit of the U.S. presence is the cash received. We believe that in a mutual security relationship the most important benefit to the base-hosting country is the tie to the world's leading democratic power, and most of our allies receive no assistance for hosting U.S. bases. We realize the GOP concerns regarding another best efforts pledge from the U.S. may complicate the upcoming negotiations for a new MBA, and we are looking at creative ways to enhance the value of assistance provided to the Philippines that will lead to a mutually acceptable agreement.

Question. Some American experts on the Philippines have suggested that the Administration should offer to turn Clark Air Force Base back to the Philippine Government and seek a long-term agreement only for Subic Naval Base. Is this a likely option outcome of the upcoming negotiation?

Answer. It is the U.S. interest to retain access and rights to facilities in the Philippines, including both Clark and Subic. These facilities have different functions, which are not interchangeable. Clark is important for air training, transit and other support activities. Subic provides essential training areas and logistic and repair facilities for naval forces. This said, the U.S. has made adjustments to make its overseas basing posture more efficent. Further adjustments are possible if approached in a careful manner, in close consultaiton with our allies and with a view toward enhancing efficiency. This larger tend of adjustment will influence the U.S. in its approach to the upcoming negotiations on a new Military Base Agreement, but specific changes in the U.S. presence in the Phillippines, if any, will be the result of consulations with the Philippine Government that will take place in the negotiation process.

AFGHANISTAN

Question. On the surface it appears that our policy in Afghanistan is meant to promote democracy for that war torn country. In reality it appears to be in chaos.

That chaos appears to be caused not only by the historic inability to the Mujaheddin tribes to unite, but by the apparent existence of a separate agenda being pursued by our Pakistani partners in the ISI. What in fact can you tell us of the coup attempt and the role of the ISI?

Answer. The attempted coup d'etat of March 6 apparently was launched by elements within the Kabul regime military that were disgruntled with Najib and other regime leaders. The leader of the coup was Lt. General Shanawaz Tanai, regarded as one of the leaders of the Khalqi faction of the People's Democratic Party of Afghanistan. Resistance leader Gulbuddin Hekmatyar came out in support of the coup plotters and directed his forces to back Tanai. Other prominent Resistance figures welcomed the coup as a serious blow to the Najib regime but refused to join with the Hekmatyar-Tanai alliance.

In the months following the Soviet withdrawal, many reports appeared of dissension within the Kabul regime and coup plotting by dissaffected military officers. In December 1989, the regime arrested at least 127 officers who were accused of planning a coup. Hekmatyar, unlike other Resistance leaders, had repeatedly expressed his support for a coup against Najib.

The extent that Hekmatyar was involved in planning for the March 6 attempt is not known. However, Pakistan has stated publicly that it has no role in or advance knowledge of this coup attempt.

Question. To what extent do Gen. Hekmatyar and his forces still receive U.S. bilateral and covert aid?

Answer. The U.S. cross-border humanitarian assistance program is designed to provide assistance to war-affected Afghans who remain in Afghanistan. We do not provide assistance to individual leaders, but to parties and PVOs which are able to deliver that assistance into Afghanistan. No resistance party has received a disproportionate amount of U.S. humanitarian assistance.

Hekmatyar heads one of two parties with exactly the same name, Hezb-i Islami. His party is one of the original seven groups which comprised the resistance alliance based in Pakistan, and through which the bulk of U.S. humanitarian resources were channelled into Afghanistan. Assistance continues to be channelled through Hezb-i Islami because it is among the better organized groups to meet the demands of needy Afghans for aid. In sum, we have channelled assistance to Hezb-i Islami as a means to accomplish an end: meeting the humanitarian needs of war-affected Afghans.

Questions concerning covert assistance, if any, should be addressed to the Administration from the Intelligence Committee.

Question. What is the long-term program in Afghanistan? Will we continue our bilaterial aid efforts at $70 million per year, or will the U.N. be picking up these programs?

Answer. We maintain strong support for war-affected populations inside Afghanistan through bilateral and multilateral programs. In FY-90, $69.5 million (including sequestration) has been allocated for A.I.D. Cross-Border Humanitarian Assistance for medical care, education and rehabilitation of agriculture. In addition we expect to continue our cross-border PL-480 food aid program. In FY-91, we are requesting an additional $70 million.

Over the longer term, we believe that the U.N. and other international organizations such as the World Bank must play the primary role on Afghanistan reconstruction. Indeed, our cross-border humanitarian assistance strategy is geared to facilitating this process. Accordingly, we cooperate with U.N. organizations and other international organizations in their efforts at meeting the humanitarian needs of Afghans in their country. For FY-90, the U.S. plans to contribute up to $14.6 million, bringing the total to over $45 million in cash and in-kind contributions that the U.S. has made to the U.N. Afghan Emergency Trust Fund.

For the time being, however, we believe the U.S. must play a major role in rehabilitation efforts. While the extent of the destruction is so enormous that it will require an international effort, continued U.S. assistance at current levels is needed over the short term.

Question. Why were food aid shipments to the resistance recently halted, and what was ISI's role in those shipments?

Answer. We temporarily suspended food deliveries—representing approximately 30 percent of our total humanitarian assistance for war-affected Afghans inside Afghanistan—in late November. This was done as a result of difficulties encountered in meeting our statutory and regulatory requirements in allocating and monitoring those shipments.

Food shipments were resumed briefly in January, but were suspended again until satisfactory monitoring arrangements are put in place. The U.S. Mission is working closely with Pakistani and Afghan Interim Government officials towards those objectives. We recently reached agreement with the Pakistanis on resuming food deliveries from Peshawar with A.I.D.-contracted monitors on board. We expect a similar arrangement to be agreed upon for Quetta in the near future.

Question. What is the status of the new Afghan shura and what are the prospects for spring/summer elections and the emergence of a unified leadership among the resistance forces?

Answer. The Afghan Interim Government (AIG) tells us that they continue to work on the plan to select representatives to a shura which in turn will select a representative leadership for the Resistance. To that end, the head of the AIG election commission, Pir Sayyid Ahmad Gailani, has made several trips to Iran in order to win the support of several Resistance groups based there. Although Pir Gailani returned in late March empty-handed from Iran, he has yet to abandon his efforts successfully to conclude these negotiations.

The United States continues to impress on all elements of the Afghan Resistance the critical importance at this time that an effective leadership that has the support and mandate to engage in efforts to find a political settlement.

Question. Has $8 million in covert aid been allocated for this election. What have the funds been used for? What will they be used for if the elections do not take place?

Answer. Questions concerning covert aid should be addressed to the Administration from the Intelligence Committee.

Question. Why have these funds been taken from the covert, as opposed to overt bilateral program?

Answer. A.I.D. is developing a program with the Afghan Interim Government and other Afghans for promoting democracy and pluralism in Afghan society. This is a long-term effort intended to foster those Afghan organizations and institutions that embrace the principles which underlie democratic practices and pluralism.

Question. It is now more than a year since the Soviet withdrawal from Afghanistan; yet the fighting continues, exacting a grave toll on the Afghan civilian population. In your view, what have been the accomplishments of U.S. policy toward Afghanistan over the past year? What initiatives are you planning on Afghanistan in the coming months?

Answer. The Soviet withdrawal, which was completed in February 1989, stands as a momentous accomplishment for the Afghan people. Unfortunately the Afghans' suffering did not end when the last Soviets left. Afghanistan has been torn apart by twelve years of brutal warfare and ten years of which they were occupied by a superpower that unleashed enormous froce against a country that had only a limited infrastructure.

The United States remains committed to supporting the Afghans in their struggle. The past year has witnessed our continued solid support for the Afghan resistance and for the over three million refugees in Pakistan and for war-affected Afghans who remain in their country. While these accomplishments do not have the dramatic impact of the Soviet forces withdrawing across the Amu river, they are major accomplishments nevertheless. We intend to continue our support for the Afghan people until they have achieved self-determination.

Concerning initiatives the United States may be planning, we will continue to explore assiduously all means to achieve a political settlement which will restore peace and tranquility to Afghanistan and which will allow the return of the refugees in safety and with honor.

Question. Secretary Baker discussed Afghanistan in a meeting with Soviet Foreign Minister Shevardnadze in mid-February. Can you outline the Soviet peace proposal made at that meeting? What are the essential points of difference between the Soviet and American positions? Do you expect that these can be resolved at an early date?

Answer. The Soviets appear to want a political settlement in Afghanistan, but they are not yet ready to accept the idea that there can be no role for Najib and his close associates in a future government of Afghanistan. The Soviets apparently continue to believe they can achieve their goal of having a stable Afghanistan without the departure of regime leader Najib and his close associates.

The Soviets have presented various proposals. Their key ideas include: an inter-Afghan dialogue, suspension of hostilities, preservation of the status quo with respect to the armed forces, internationally supervised elections, an international conference, termination of all military supplies to the combatants and announcement of a halt in military operations.

We continue to stress to the Soviets that because of the depth of Resistance convictions that Najibullah is unacceptable, the most important condition for the success of a negotiated settlement would be the transfer of power from Najib and his close associates to a broad-based representative government acceptable to the Afghan population. Thus the main difference between the U.S. and Soviet positions centers on the role of the Najib regime in a transition process.

We believe that Soviet long-term interests are served by Najib's departure; hence they may come to agree with us on this matter.

Question. What is the level of Soviet military and economic assistance to the Najibullah regime? In your view, why are the Soviets making such a heavy commitment to the survival of Najibullah as compared to the former communist rulers in Eastern Europe? Why has the United States insisted on the departure of Najibullah as a pre-condition to any settlement?

Answer. We estimate $250-300 million worth of equipment and supplies per month, but it is difficult to delineate the precise level of Soviet military and economic assistance to the Najib regime. The amount of aid poured into Afghanistan by all accounts dwarfs that provided to the Resistance by its friends. The air bridge which brings military weaponry into Kabul from the Soviet Union has been described correctly as the largest sustained airlift since the Berlin airlift of 1948.

The Soviet commitment to the survival of Najibullah is puzzling in light of their policy towards the recent changes that have been transforming Eastern Europe. We are confident, however, that their current policy is counterproductive to a long-term goal of good relations with Afghanistan. Soviet influence in Afghanistan could best be maintained by quickly bringing the current hostilities to an end, by facilitating the replacement of the illegitimate Kabul regime with a representative regime, and then by endeavoring to establish proper relations with this sovereign, legitimate government as soon as possible.

The United States has insisted on the departure of Najib because we are convinced that this is the position of the Afghan people themselves. The United States neither supports nor opposes any particular individual to lead an Afghan government as long the leader is acceptable to the Afghans.

Question. Some five million Afghans are living as refugees in Pakistan and Iran, while those who remain within the country face food shortages and other hardships, as well as the constant risk of injury or death from the ongoing war. Education and health care systems have been severely damaged by the prolonged conflict. Can you outline U.S. efforts to help the Afghan people and ease the burdens that war has imposed?

Answer. We have maintained strong support for war-affected populations inside Afghanistan through bilateral and multilateral programs. Since 1985 when A.I.D.'s cross-border program began, we have provided nearly $100 million to support programs in agriculture, health, education, and general relief assistance. In FY-90, $69.5 million (including sequestration) has been allocated for A.I.D. cross-border humanitarian assistance. In addition, we expect to continue our cross-border PL-480 food aid program For FY-91, we are requesting an additional $70 million.

We also cooperate with U.N. organizations and other international organizations in their efforts to meet the humanitarian needs of Afghans in their country. For FY-90, the U.S. plans to contribute up to $14.6 million, bringing the total to over $45 million in cash and in-kind contributions that the U.S. has made to the U.N. Afghan Emergency Trust Fund.

Question. According to a recent press report, there have been serious problems in the Afghanistan humanitarian assistance program. Food aid, medicines, and money—according to the allegations—have been stolen or diverted to purposes other than relief. Both resistance leaders and Pakistani intelligence officials are allegedly involved. Some observers also maintain that many schools and clinics, which were supposed to be established with U.S. funds, were never in fact built.

How serious are the problems in the humanitarian relief program? What steps have been taken to deal with these problems? Do you anticipate difficulties in obligating the funds earmarked for humanitarian assistance in Afghanistan in FY 1990?

Answer. Security considerations have prevented U.S. personnel from travelling into Afghanistan to monitor the programs, but non-U.S. citizen personnel have been successfully used. A.I.D. has developed the best possible monitoring system in light of these limitations. Each project has a monitoring system in place inside Afghanistan and along the border to verify that supplies are indeed reaching Afghanistan. A.I.D. has stopped programs when it has been unable to ensure that this is the case.

A.I.D. continues to refine and improve its delivery and monitoring programs within the constraints that the hostile circumstances impose on this innovative program. In this light, we will continue to review the policy of not permitting official Americans inside Afghanistan.

We do not anticipate any particular difficulties in obligating the funds earmarked for humanitarian assistance in Afghanistan in FY 1990.

Concerning allegations that many schools and clinics, which were supposed to be established with U.S. funds, were never built, A.I.D. provides no funding for construction activities for either schools or clinics. The Health Sector Support Project provides medical, technical, and financial assistance to strengthen health services inside Afghanistan. The Education Sector Support Project provides literacy training, teacher training, textbook development, and a scholarship program for Afghan students in the United States.

Question. According to a number of reports in the press, many Afghan civilians have come to resent the United States for supplying rockets and other weapons that are fired into towns and cities by the resistance forces. Do you have any reason to disagree with such reports? What steps have been taken to prevent attacks on civilian areas?

Answer. Afghans living in Kabul and elsewhere are tired of war and the suffering they have endured as a result of the April 1978 coup and the Soviet invasion. It is understandable that Kabul dwellers are unhappy about Resistance rocket attacks on Kabul resulting in civilian casualties.

We should not forget the millions of Afghans living outside the few urban areas controlled by the PDPA who are also suffering from air, missile and artillery attacks. I am sure that they would not blame the Resistance for their suffering.

The Kabul regime has mounted a steady propaganda campaign blaming practically everyone except themselves and the Soviets for prolonging the war. We believe most Afghans still have a clear understanding of who bears responsibility for the eleven years of suffering.

We have discussed with the Resistance on numerous occasions the harm that civilian casualties have for their cause. They have assured us that their goal is keep civilian casualties to a minimum. After all, any civilian casualties are Afghans, possibly relatives or friends of Resistance fighters.

U.S. ASSISTANCE TO AFRICA

Question. Why hasn't the Administration placed an emphasis on providing additional assistance for Africa?

Answer. The creation of the Development Fund for Africa (DFA) in FY 1988 was explicit recognition by the Congress and the Administration that Africa has special economic development needs. Our request for the DFA has increased over time: the FY 1991 request is 12% higher than the FY 1988 request. ESF, allocated to countries where the United States has important political and security interests, also promotes development objectives. For example, our FY 1990 ESF request for Chad included funds to help pay the salaries of Chadian economic development officials. The allocation of Economic Support Funds (ESF) for Africa over the same period, however, has decreased, due to a combination of underfunding and substantial earmarking in the account as a whole.

Question. In light of the problems in Africa why have you proposed a decrease (from $573 to $560 million) in funding for the Africa Development Fund?

Answer. While the FY 1991 Development Fund for Africa (DFA) request of $560.5 million is slightly less than the FY 1990 request of $565.0 million (and the FY 1990 allocation of $561.8 million), the actual amount available for Africa's long-term development will increase. Some $15 million of the FY 1990 appropriation is reserved for use exclusively in Africa if disasters arise there that cannot be accommodated within the FY 1990 International Disaster Assistance appropriation of $25 million. For FY 1991, we are requesting that the Office of International Disaster Assistance (OFDA) receive $40 million, and we do not plan a disaster reserve within the DFA. As a result, the amount of DFA immediately available for 1991 for Africa's long-term development will increase as follows: $13.5 million over the FY 1990 allocation, a 2.5% increase. $10.5 million over the FY 1990 request, a 2% increase.

Question. Explain how the Administration's $53 million program in Zaire, $22 million in Malawi and $9 million program in Somalia are moving those countries toward higher principles of democracy.

Answer. As there are only five countries in Africa that have fully democratic political systems, were we to make the demonstration of achievement in this area a criterion for U.S. aid, we would be forced to scale back assistance to countries where our programs are promoting positive change in many areas. U.S. assistance programs in Africa are targetted primarily at humanitarian concerns and economic development. Our economic development assistance emphasizes economic reform and movement towards market orientation. Progress in these areas promotes transition to political pluralism as well, so there is an important democratization component in our assistance program, though it is not explicit and is aimed as the long-term.

U.S. importance as a major aid donor also enables us to prevent or reverse human rights abuses by means of quiet diplomacy. In addition, the Department of State does have a limited amount of funding ($450,000 in FY 1990) dedicated solely to human rights programs in Africa.

Question. You have recommended that the "traditional concepts of what constitutes a threat to national and global security need to be updated and extended to such divergent concerns as environmental degradation, narcotics trafficking and terrorism." Explain how you would implement this recommendation within the United Nations framework.

Do you anticipate that the UN Security Council or the UN Economic and Social Council would declare any or all of these concerns as a "threat to the maintenance of international peace and security," as refered to under chapters VI or VII of the UN Charter?

What changes, if any, would you recommend for improving the capacities of the United Nations system to deal with these new global dangers? Please explain.

Answer. The State Department believes that Articles VI and VII of the UN Charter adequately define what can be considered by the Security Council; these provisions need not be amended. However, in certain cases, the United States can urge other members of the Security Council to interpret these provisions flexibly, particularly where there is clear evidence of a threat to international peace and security.

For example, in the summer of 1989, the U.K. with U.S. support, sponsored a Security Council resolution which expressed solidarity with President Barco and the Colombians in their attempt to deal with the narco-terrorist violence that erupted in that country. In the end, the Council decided this matter was more appropriately the responsibility of the General Assembly, thus leading to the UN Special Session on Narcotics. Whether in the future the Security Council would declare such an issue a threat to international peace and security would depend on the nature of the proposal. At the moment, none of these issues is before the Security Council for consideration.

We are pleased that the UN is expanding its activities in areas such as environment, narcotics and terrorism, which need urgent attention. The UN held a Special Session on Narcotics in February 1990, which adopted a Global Plan of Action and a political declaration. We are pleased with the outcome of this session, which recommended substantive action by the UN in international narcotics control. In addition, the U.S. is participating in an expert group, convened by the Secretary General, which will look at ways to strengthen the UN drug control structure.

As the international community addresses growing worldwide concern about the environment, a variety of ideas are being developed to improve the institutional capability of the UN system to deal with these issues. Planning has begun in earnest for the 1992 UN conference on the environment. We envision that this conference will provide the means to carry out a comprehensive evaluation of UN activities related to the environment and make recommendations on specific institutional improvements which may be desirable for handling environmental affairs in the UN system.

Question. Some observers have remarked that the U.S. foreign affairs establishment is not adequately prepared to succeed in a leadership role in the multilateral arena. They cite lack of continuity in senior positions and at the staff level, where the turnover rate averages two to three years. What steps would you recommend to eliminate or significantly reduce these problems?

Answer. We do not agree that there is a significant problem with continuity for staff and leadership positions in multilateral fora. Except for the most junior, untenured employees, tours of duty in positions at U.S. offices in international organizations usually last three to four years. We believe such tours of duty are fully adequate to maintain a level of continuity which we agree is desirable. Furthermore, many employees occupying leadership positions have had one or more previous assignments in the international arena, thus providing us with the necessary expertise which we need in the area of multilateral diplomacy.

Question. Assignments in international organization-related positions are often viewed as undesirable and without relevance for advancement in one's Foreign Service career. Has any serious consideration been given to creating a multilateral diplomacy cone within the Foreign Service?

Answer. In recent years, especially since the establishment of multifunctional promotions to encourage the development of the broadest possible range of expertise in the Service, assignments to international organization-related jobs have become increasingly attractive to Foreign Service Officers. The proposed plan to establish a multifunctional professional cone should, if approved, further promote this trend. We note no general reluctance by Foreign Service Officers to seek positions in international organizations.

Questions for the Record From Mr. McHugh

SUBMITTED TO DEPARTMENT OF STATE

PHILIPPINE BASES

Question. Given the improvement in East-West relations, why is it still strongly in the interest of the United States to maintain major bases in the Philippines to project power and keep open strategically important air and sea lanes? Who are we protecting and from what?

Answer. While the prospects for East-West conflict appear to have diminished, positive developments in the security situation in Europe have not been matched in the Asia-Pacific region. Soviet military forces continue to grow more effective and more lethal. Regional powers such as India or China continue to grow in military strength. Regional tensions with the potential to erupt into armed conflict, the most dangerous of which is on the Korean peninsula, remain a serious concern.

While the changing security situation in Asia has lagged behind Europe, our interests there continue to grow. The most visible sign of this is that Asia is now our largest trading partner. The increase in our economic and political ties to the region make retaining a U.S. military presence in the Asia-Pacific theater vital. Turmoil or conflict in Asia could have disruptive effects for the United States. Our military presence acts to deter conflict and enhance stability, and helps maintain a friendly political and economic environment for U.S. interests. The level of that presence can be adjusted as required for greater efficiency, but the need for forward deployed forces and the facilities to support them will remain.

Question. Do the bases contribute to the stabilization of the Aquino government specifically and the democratization process generally?

Answer. The U.S. presence in the Philippines contributes to stability and democratization in that country. In addition to enhancing Philippine security and as part of the larger U.S.-Philippine relationship, the U.S. presence allows the GOP to concentrate scarce resources on its counterinsurgency effort and on broad-based economic development. The facilities themselves provide considerable economic benefit to the Philippine economy through purchases and employment. They act to promote stability as well as both development and democracy in the Philippines.

Question. If we were to move the bases, for whatever reason, where would we move them and at what cost?

Answer. After the 1988 Military Basing Agreement (MBA) Review, Congress asked DOD to report on the importance of U.S. facilities in the Philippines and options for moving. DOD's report examined a range of possible alternatives to U.S. facilities in the Philippines, including other locations in Asia or the construction of new bases in U.S.-affiliated islands such as Guam, Tinian or Palau, and the potential costs of these options. The Department of Defense is the best source of specific estimates of these potential costs.

While alternatives exist, we would prefer to retain our facilities and basing rights in the Philippines, under an agreement that is acceptable and beneficial to both countries.

PHILIPPINES: AQUINO GOVERNMENT

Question. What is the situation with regard to future threats from the military to topple the Aquino government? Does the military have legitimate grievances that Mrs. Aquino is not addressing? If so, what are they?

Answer. President Aquino's Government is in control in the Philippines and continues to consolidate its position following the December coup attempt, President Aquino has taken important, measured steps to limit the economic disruption caused by the coup attempt to bring new leadership into government, to improve intelligence gathering, and to hinder new coup plotting and logistics. The Philippine Government has apprehended some major participants in the coup attempt and plans to press charges against them vigorously.

Only a small minority of the armed forces participated in the coup attempt. Some of the rebel leaders were former officers implicated in previous coup attempts and have been fugitives for some time.

The rebels sought to justify themselves by claiming that they were acting for the good of the nation—to fight corruption and the Communist insurgency and reform the armed forces. However, their actions threaten the entire democratic structure built since 1986 and future economic progress and political stability. Their justifications thinly cloak a desire to grab power.

The Philippine Government is now conducting a thorough investigation into the causes of the coup attempt. In the meantime, efforts to modernize and reform the Armed Forces of the Philippines are continuing. This is part of a long-term process being carried out under the direction of President Aquino, Secretary of National Defense General Ramos, and Chief of Staff General de Villa. The United States is contributing to this reform effort through our security assistance program.

Question. What is the Aquino Government's strategy in dealing with the insurgency and how successful has it been?

Answer. The Aquino Government understands that the root causes of the Communist insurgency must be addressed. The government is doing so by measures that include reintroducing and expanding democratic institutions, promoting broadly based, equitable economic reform and growth, and more effective military operations.

Since the end of the Marcos regime in early 1986, the insurgency has been blunted. The Communist party, and its military arm, the New People's Army (NPA), have suffered from internal dissent, purges, and lessened popular support. Philippine Government information indicates that the strength of the NPA has begun to decline. Nevertheless, the insurgency remains a serious long-term threat to the Philippines.

Question. We continue to receive reports that military bombings and attacks by vigilantes organized by the military are creating growing civilian discontent with the government as well as large numbers of refugees and internally displaced people. What is your assessment of the military's performance in these respects?

Answer. Armed Forces of the Philippines (AFP) efforts to combat Communist insurgent activities (i.e., ambushes, extortion, etc.) have had an impact on civilian populations. In an effort to "dismantle" the Communist Party's New People's Army (NPA) political bases, the AFP has at times temporarily displaced substantial numbers of civilians in several provinces of Mindanao and on the Negros island. The Government has made efforts to provide food and medical supplies, but poor sanitation conditions have sometimes led to serious health problems. The Government's Department of Social Welfare and Development (DSWD) reported 188,000 affected persons from January 1 to December 27, 1989, and an additional 30,000 affected by the December coup attempt. DSWD provided relief services to 187,000 people in 1989. There were occasional reports of indiscriminate firing on civilians in villages suspected of supporting Communist insurgents.

The AFP continues to be engaged against the NPA, which is dedicated to the violent overthrow of the Aquino Government. The AFP has established and supervises local militia units, the Citizens Armed Forces Geographical Units (CAFGUs), to fight the Communist insurgency. Individuals in these self defense groups—sometimes erroneously referred to as "vigilantes"—have occasionally committed human rights violations. Such violations are not encouraged or sanctioned by the Government, and in fact have been condemned by President Aquino. There is no evidence that the Government encourages or organizes attacks by CAFGUs or vigilantes.

Question. How does the Communist insurgency keep going and what are their demands? What would it take for them to lay down their arms and join the political process?

Answer. The Communist insurgency in the Philippines is able to keep going because of widespread poverty and lack of effective government presence in a significant part of the rural Philippines. Although the momentum of the Communist Party of the Philippines (CPP) and its military wing, the New People's Army (NPA), has been blunted since President Aquino came to power and democratic institutions were restored, the party can still draw on the infrastructure it developed during the Marcos years. It maintains itself by recruiting heavily among rural youth who often see little prospect for the future and are easily caught up in the romanticism of a revolutionary movement. Communist leaders often come from university backgrounds. There is a high attrition rate among younger followers, while senior party members often live comfortably in "safehouses" in Manila or in overseas exile financed by "revolutionary taxes" extorted from businesses and individuals, and contributions from well-meaning but naive groups abroad. Communist "tax collection" methods are often brutal. On March 6, S ward Raab, a 73-year-old American cattle rancher on the island of Masbate, was shot to death by the NPA for refusing to pay such "taxes."

The CPP grew from "Maoist" roots in the late 1960s and is largely self-sufficient. While Marcos was in power, the party gained some sympathy because of its opposition to his rule. The CPP successfully exploited economic, political, and human rights abuses of the Marcos Administration. The party has had a far more difficult time since the advent of a democratically elected government in 1986.

The goal of the Communist Party is to seize power by any means, including "armed struggle," and turn the present Republic of the Philippines into a Marxist-Leninist state for which they have already chosen the name "People's Democratic Republic of the Philippines." CPP demands for "political reform" are tactical propaganda aimed at masking the insurgents' real intentions. For instance, the CPP has announced that it will "call a unilateral ceasefire" if only President Aquino will unilaterally end the U.S. military presence in the Philippines. The Aquino Government has rejected this proposal.

Partly to overcome setbacks since President Aquino came to power, and partly to "speed up" its intended seizure of power, the CPP has come to rely increasingly on terrorist acts, particularly in urban areas. Dozens of Filipinos have been murdered by NPA assassination squads, and the toll since 1987 also includes eight Americans. This resort to terrorism belies any serious intent by the insurgents to participate in the political process. CPP front groups have been singularly unsuccessful when they have taken part in elections.

It is unlikely the CPP/NPA will soon lay down its arms. The best that can be hoped for is that government social, economic, and administrative programs, combined with the continuing efforts of the Armed Forces of the Philippines, will undermine the appeal of the Communists and progressively weaken the NPA until the movement is unable to sustain itself. U.S. assistance programs are aimed at promoting the economic development and providing the military training and equipment needed to help preserve democratic government, bring improvement to the livelihood of the Filipino people, and contain and ultimately reverse the Communist challenge.

Question. Is Mrs. Aquino's security situation so precarious that the U.S., because of its commitment to stability and to the democratization process, is ultimately going to find itself faced with having to use military force either against elements of the military or the insurgents?

Answer. The Aquino Government has made significant progress since 1986. Democracy has been restored and economic growth restarted. While there have been serious coup attempts—and we cannot completely rule out a future incident—the Government has each time moved to restore order. Although major challenges remain, we expect progress to continue. We will continue to do what we can to assist the democratically elected Philippine Government achieve its objectives. However, it would not be productive to speculate on hypothetical future situations relating to coup attempts or the Communist insurgency and possible U.S. military intervention.

Question. How widespread is corruption within the Aquino government? Is it affecting economic recovery, political stability, or counter-insurgency efforts?

Answer. Corruption is a longstanding problem in the Philippines. Addressing this problem is important for continued economic recovery and political stability. Corruption, deeply entrenched during the Marcos era, was practiced by those in the highest levels of government. By contrast, President Aquino's integrity is above reproach and she has taken concrete steps to deal with corruption.

President Aquino places strong emphasis on anti-corruption efforts, reflected by 1989 legislation granting the Office of the Ombudsman broad powers to investigate all government officials accused of official misconduct. Since 1987, over 10,000 allegations against government employees have been referred to the Ombudsman. More than 2,000 cases have been dismissed, and 600 cases have been referred to the Sandiganbayan, the special anti-corruption court, for possible prosecution, with the rest under investigation and evaluation. No senior officials have been convicted of corruption.

President Aquino dismissed senior officials of the Department of Agrarian Reform, including a Cabinet secretary, over a land scandal in 1989. Often, well-founded allegations of corruption against a senior official result in the official's dismissal or resignation. An investigation is usually ended with the official's removal from office. A significant number have been discharged in this manner. Under President Aquino, the Bureau of Customs and the Bureau of Internal Revenue, traditional havens of corruption, have been reinvigorated with fresh leadership and have significantly increased their collections, a favorable sign.

PHILIPPINES: ECONOMIC DEVELOPMENT

Question. What is the status of the economic recovery effort, i.e., what measures have been adopted and what are still needed? What is happening with regard to the Multilateral Assistance Initiative in particular?

Answer. The Philippines has had three solid years of economic growth since President Aquino took office in 1986. In a reversal of the decline of the economy in the last years under Marcos, GNP grew 5.9 percent in 1987, 6.6 percent in 1988 and an estimated 5.5 percent in 1989. Per capita GNP has also increased and now stands at about $735.00. Poverty rates have declined from 59 percent when Aquino became President to about 49 percent now. Unemployment has declined from double digits to 8.6 percent in October 1989, though underemployment remains high.

Much of this economic improvement is due to the restoration of confidence and a series of economic policy reforms undertaken by the Aquino Administration. While much has been accomplished, the Philippines still faces difficult economic problems. The trade deficit is growing and could be difficult to finance this year. The budget deficit, under considerable pressure, is above targeted levels. Inflation has risen (10.6 percent average in 1989) due to excessive growth in the money supply and commodity shortages exacerbated by an ongoing drought and the December 1989 coup attempt. The Philippines must also service a foreign debt of about $27 billion. Poverty remains unacceptably high. These problems pose difficult policy choices for the government in the coming months.

The MAI was launched in Tokyo in July 1989, when 19 countries and seven international organizations pledged a total of $3.5 billion in assistance for the Philippines. The United States will provide $160 million in assistance under the MAI in FY 90 to support project preparation and preinvestment studies, improvements in management of natural resources and the environment, a development project on Mindanao, policy reforms, and a capital projects funding facility. The AID Mission in Manila has already obligated $11 million for project preparation and other activities and is preparing the other projects for funding.

The Administration is seeking $200 million for our contribution to the MAI in FY 91. Continued U.S. leadership in the MAI will be necessary to encourage other donors to continue their support. The success of the MAI in achieving its aim to support democracy by promoting self-sustaining growth and improved living conditions will be increasingly important as the Philippine Government deals with the difficult economic problems it faces.

Question. The Philippines has a $29 billion foreign debt which requires $3 billion in payments each year. What is the status of debt reduction efforts?

Answer. The Philippines recently concluded a three-part debt reduction/new money agreement with its commercial bank creditors. The first part of the agreement was the rescheduling of outstanding medium- and long-term Philippine debt. The second part was a buyback of debt by the Philippine Government from banks that wished to withdraw from the Philippine market. This was accomplished on January 3, 1990, when the Philippines, with assistance from its bilateral and multilateral donors, bought back about $1.3 billion of debt at a 50 percent discount, commiting about $650 million of its limited foreign exchange reserves to the transaction. Finally, the third part of the agreement was concluded on February 28, when creditor banks of the Philippines agreed to provide about $710 million in new financing.

The Philippine Government's responsible debt management policy and continued debt service, despite the strain on its resources, and the debt buyback have reduced its outstanding foreign debt to about $27 billion.

Question. How effective has our aid program been in addressing rural development problems such as unemployment and rural poverty?

Answer. A.I.D.'s program has concentrated on several areas, including:

Development of physical infrastructure in rural areas, delivery of basic services, and technical assistance for institutional development;

Support for needed reforms and continued provision of essential services in education, health, agriculture, and population;

Policy dialogue efforts ranging from studies to linkage of aid disbursements to implementation of reforms, which have helped the Philippine Government articulate, prioritize, and implement important policy reforms essential for broadly-based, sustainable growth, led by the private sector.

Our A.I.D. program is only one of many factors that have impacted on rural development problems. However, with improvements in economic management, policy reforms, and significantly increased donor assistance, the Aquino Government has attained: a marked recovery from the 1983-5 economic contraction, with 4.7 percent real growth in 1987 and an average of over 6 percent real growth in 1988 and 1989; increased rural employment by 2 percent per year between 1985 and 1989; reduced poverty incidence in areas outside metropolitan Manila, from 61.3 percent to total families in 1985 to 52.2 percent in 1988, with the number of poor families declining in absolute terms from 5.23 million in 1985 to 4.82 million in 1988.

For the future, U.S. support for realization of sustainable broadly based growth led by the private sector will generate new employment opportunities for the Filipino people, thereby reducing poverty. Development of infrastructure also will provide population groups outside of Manila with greater access to markets, goods, and services.

Question. Has the land reform program been effective?

Answer. The Philippine Government's Comprehensive Agrarian Reform Program (CARP) is a ten-year program inaugurated in 1988. It covers practically all agricultural lands. Overall CARP targets for the ten-year period are to distribute 10.3 million hectares of lands to 3.9 million beneficiaries. Annual targets for the ten-year period were announced, but have been adjusted periodically.

In 1988 and 1989, 269,437 hectares were distributed to 263,804 beneficiaries. This constitutes less than 3 percent of the CARP target for land distribution and about 6.8 percent of the target for beneficiaries. If progress continues at this rate, at the end of CARP's ten-year life, land redistribution will total about 1.5 million to 2 million hectares (10-15 percent of the target) and 1.5 million beneficiaries (about 40 percent of the target).

Question. What is the state of family planning programs under President Aquino?

Answer. In May 1987, the GOP issued a population policy statement based on the 1986 Philippines Constitution. The policy statement identifies program approaches that provide for the delivery of health, nutrition, and family planning services to be integrated and treated as a vital component of comprehensive maternal and child health care. Couples are to be given complete information on medically approved and legally acceptable family planning services to ensure a sound basis for their free, informed choices.

In August 1988, the Department of Health was designated as the lead agency for family planning services. In her July 1989 State of the Nation address, President Aquino identified family planning and responsible parenthood as one of three critical priorities.

In 1989, A.I.D. and the Philippine Department of Health collaboratively developed the $62 million five-year Family Planning Assistance Project (FPAP) as a follow-on to the Population III Project. The project will enhance the ability of the public and private sectors to deliver family planning services.

Question. What safeguards exist to ensure that U.S. provided food aid to the people in areas held by the Afghan resistance is getting safely through Pakistani channels?

Answer. While A.I.D. officials—like other U.S. citizens working directly or indirectly for the U.S. Government—are prohibited from entering Afghanistan, each A.I.D. project has a monitoring system in place using independent Afghan monitors in an effort to varify that supplies are indeed reaching Afghanistan. We are constantly working to strengthen these systems. A.I.D. has stopped programs when it has been unable to ensure that this is the case.

A.I.D. continues to refine and improve its delivery and monitoring programs within the constraints that the hostile circumstances impose on this innovative program.

Questions for the Record From Mr. Porter

SUBMITTED TO AGENCY FOR INTERNATIONAL DEVELOPMENT

A.I.D. PRIVATE SECTOR CONCERNS

Question. Given the vital role we are seeing in the private sector I think we can all agree that A.I.D. should upgrade private sector concerns. One of the ways we could help is to make your own office of Private Voluntary Cooperation report directly to the Administrator instead of going through many layers of administration. Would you recommend such a move to the new Administrator Mr. Roskens?

Answer. I completely agree with your statement that a strong private sector is a vital component in first stimulating and then sustaining economic and social development. A.I.D. currently works closely with developing country governments encouraging privatization and policy changes to facilitate growth in the private sector. Program initiatives that A.I.D. implements with U.S. for-profit and non-profit development agencies draw together the public and private sectors both here and abroad. You can be assured that A.I.D. policies and programs will continue to stress the importance of the private sector.

Your suggestion that the Office of Private and Voluntary Cooperation report directly to the Administrator intimates that presently the Agency's programs with the non-profit private sector suffer because of inaccessibility to the A.I.D. Administrator. This is simply not the case. The Office of Private Voluntary Cooperation is currently managed by a Deputy Assistant Administrator with significant policy and operational input from the Assistant Administrator for Food for Peace and Voluntary Assistance. Both of these individuals participate in formal and informal briefings with the Administrator keeping him informed of new program and policy initiatives.

RUMANIA: A.I.D. POPULATION PROGRAM

Question. One of the most insane policies of the previous Rumanian government was their opposition to family planning and law forcing women to have at least four children.

Now that this policy has ended, is A.I.D.'s population program capable of responding?

Answer. Prior to the political changes which took place at the close of 1989, no contraceptives were available in the country. Fertility was controlled by reliance on traditional methods of withdrawal, rhythm and abstinence. Abortion was legalized the day after the Government fell, and the Government ban on contraceptives was lifted the first week. In the first few months of 1990 the donor community has been trying to meet the growing demand for a wide range of contraceptives including pills, IUDs, and condoms.

Given the responsiveness of other donors, there may be no need for A.I.D. to take an active role in Romania at this time. We will continue to monitor the situation.

Question. What about UNFPA? Haven't they already sent a team in to set up Rumania's family planning program? If the Congress wanted to help the Rumanian family planning program, providing some money to UNFPA would be about the only efficient way, correct?

Answer. We are aware of the involvement of some international donors currently planning and providing family planning assistance. The United Nations Population Fund (UNFPA), for example, has just completed a needs assessment which resulted in the following actions:

Development of an emergency family planning/maternal and child health project valued at $325,000 to provide contraceptive supplies, training and public health information;

Five million dollars to provide long-term assistance in population census work, family planning/maternal and child health and information, education and communication.

The International Planned Parenthood Federation (IPPF) has also completed a recent assessment and actions that include the following: Support of a private family planning association; a program of physician training in urban and regional hospitals; translation of medical books into Romanian; and various contraceptive supplies.

On March 28, 1990, Congressman Kostmayer introduced an amendment to H.R. 4445, the FY 1990-91 foreign assistance authorization bill pending in the House Foreign Affairs Committee, calling for A.I.D. to provide family planning support to Romania through the UNFPA and the IPPF. Legislation and Administration policy would prohibit such a plan.

Since the Kemp-Kasten amendment was enacted in 1985, the UNFPA has not received U.S. assistance because of UNFPA's support for the family planning program in China were implementation of the government's one-child per family policy has result in coerced abortion and involuntary sterilization. The Kemp-Kasten amendment prohibits all assistance to an organization which supports or participates in the management of a program of coercive abortion or involuntary sterilization. This provision prevents A.I.D. from making any contribution to the organization even if U.S. funds are limited for use in Romania. This limitation would be comparable to the Mikulski amendment which prompted President Bush to veto the FY 1990 foreign assistance appropriations bill.

As for IPPF, under the Mexico City Policy, a foreign nongovernmental organization is ineligible for population assistance if it performs or actively promotes abortion as a method of family planning in foreign countries. In 1985, IPPF refused to change its program in order to be eligible for assistance from A.I.D. under this policy.

Our plan at this time is to continue monitoring the needs and major donor activities in family planning in Romania as we evaluate the efficacy of bilateral support.

RUMANIA: AIDS

Question. Still on Rumania, we all heard terrible stories about over 900 orphans who had contracted AIDS due to the backward medical system there. This is of course on top of 2,000,000 cases in Africa where patients have no hope of extending their lives with AZT and anti-biotics. Could you give us A.I.D.'s AIDS update?

Answer. We know relatively little about the epidemic in Rumania. As of December 1, 1989 only sixty-nine cases of AIDS had been reported to the WHO Global Programme on AIDS from Rumania, although this is widely understood to be an underestimate of the true number. Recently, however, the Rumanian government requested WHO assistance in connection with an "outbreak" of 300 to 500 AIDS cases among a population of 50,000 orphans in three areas of the country (Constanta, Giurgiu and Bucharest). These children were almost certainly infected through the practice of "microtransfusions" in which a small amount of plasma pooled from as many as 30 donors was administered to malnourished children to "ward off" infections. The situation is further complicated by the unavailability of sterile needles and syringes.

During the first week of February Dr. David Heymann of the WHO/GPA in Geneva and Dr. Alexander Gromyko of WHO's regional office in Europe went to Rumania at the request of the Minister of Health. This mission was a part of a larger WHO programme initiated at the request of Rumanian Government officials in December 1989. The team returned and made six recommendations: (1) to begin the testing of transfused blood and to stop transfusion-related HIV transmission, (2) undertake a more thorough epidemiologic study of the epidemic, (3) stop transmission resulting from non-sterile techniques in hospitals, (4) educate those concerned about HIV and AIDS, (5) treat and support those infected, and (6) develop a national AIDS control program.

The necessary immediate steps have already been taken by the WHO/GPA; the longer-term response is being developed following a second mission to Rumania which was undertaken during late March by the WHO/GPA office in Geneva and the European Regional Office in Copenhagen. Coordination of the activities outlined in this plan will be essential and the U.S. will work with the WHO/GPA as it or any NGO it supports develops a response.

Original WHO/GPA estimates of the AIDS preventionneeds for Rumania are being reviewed and revised. We are in daily contact with WHO/GPA staff in Geneva and are advised that we will be notified promptly whether any additional support from the U.S. Government is needed.

SUBMITTED TO DEPARTMENT OF THE TREASURY

EUROPEAN BANK: ENVIRONMENTAL PROVISIONS

Question. Last week, you indicated that the current draft charter of the EBRD includes two provisions concerning the environment. Could you elaborate on these provisions? Does Article 35 mean that Environmental Impact Statements will be done for each project?

Answer. The environmental provision in Article 2 of the current draft charter clearly establishes the environment as an important priority for the Bank. It states that, as one of eight basic functions, the Bank will assist recipient countries to promote in the full range of its activities environmentally sound and sustainable development. Article 35 in the draft charter provides that the Bank shall report annually on the environmental impact of its activities, and that it may publish such other reports as it deems desirable to advance its purpose. This provision indicates that the Bank will review the environmental impact of its activities.

In addition, we will encourage the Bank to complete an environmental impact assessment (EIA) for each project that will have a significant impact on the environment. We anticipate that this issue will be dealt with in the preparation of the Bank's policies and procedures.

Question. Will there be any provisions in Article 35 for public participation in the environmental assessment process? Or for consultation with NGOs and public interest groups?

Answer. There is no provision in Article 35 for public participation in the Bank's preparation of its annual environmental report. However, Treasury has taken the position that public participation is an essential element of any EIA process, and will press in subsequent discussions for explicit recognition of the need for such participation in the Bank's EIAs. We will also place a high priority on consultations with NGOs and public interest groups, and will encourage more explicit provisions regarding the role these organizations can play in improving the quality of the EIA process and individual projects.

Question. I understand that the negotiators are currently selecting a President for the EBRD. Are there currently plans for a Vice Presidency for public health and environment?

Answer. We have not yet reached the point of discussing organizational and personnel issues such as whether or not there should be a vice president for public health and environment within the Bank. We do believe it is important to have an environmental line unit within the Bank, similar to those in the other MDBs. Such a unit should be adequately staffed with well-qualified professionals and integrated effectively into the Bank's structure and operating procedures. At this point, we have not gone further to determine what the grade levels should be for any of the managers or the head of the environmental unit.

Cote D'Ivoire: IMF Austerity

Question. The present IMF agreement with the Cote d'Ivoire set off riots in that country. Unlike other West African countries, the Cote d'Ivoire has always had its economic house in order. It has been the decline of cocoa prices that has strained the economy and required IMF support. Any thoughts on easing up this austerity plan for now?

Answer. It is true that for a number of years following its independence, the Cote d'Ivoire was an African economic success story. It is also true that the decline of cocoa prices a few years ago started the economy on a downward slide.

I cannot agree, however, the Cote d'Ivoire has always kept its economic house in order. The Government maintained artificially high cocoa prices for domestic producers, and it responded to the fall in cocoa prices by withdrawing from the international market and stockpiling cocoa, in the hope that the market would rebound. The predictable result has been a huge fiscal deficit, a loss of liquidity in the banking system, and mounting arrears on domestic and international debts.

Although the GOCI has since significantly reduced cocoa prices for domestic producers and reentered the cocoa market, severe structural problems still need to be addressed. We are firmly convinced that failure to implement appropriate policies will compound the Cote d'Ivoire's financial difficulties and the burden on the Ivoirian populace. Following through on the austerity measures worked out with the IMF and IBRD is essential if the Ivoirian economy is to recover.

Submitted to Department of Defense

Philippines: Vigilante Units

Question. Several human rights groups are concerned about the vigilante units, called CAFGUs, that the Philippine government has encouraged. What have we said to their military about the conduct of these units?

Answer. The government has retained its strong commitment to human rights and we noted improvement in the military's performance during 1989. Statistics on human rights violations are problematic: most statistics cannot be independently verified, many incidents are probably unreported, and investigations are often inconclusive. By most accounts, however, military abuses have declined. Popular polls indicate the Philippine people believe the military is less abusive than during the Marcos regime. We cannot provide specific information on the CAFGU's. My impression is that its human rights performance, while somewhat mixed, is better than that of its predecessor, the Civilian Home Defense Force.

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